IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

I TE KŌTI MATUA O AOTEAROA
TĀMAKI MAKAURAU ROHE

CIV-2015-404-1094
[2019] NZHC 255

BETWEEN	MAINZEAL PROPERTY AND CONSTRUCTION LIMITED (IN LIQ) First Plaintiff
AND	KING FAÇADE LIMITED (PREVIOUSLY KNOWN AS RICHINA LAND LTD) (IN LIQ) Second Plaintiff
AND	MAINZEAL GROUP LIMITED (IN LIQ) Third Plaintiff
AND	ANDREW JAMES BETHELL AND BRIAN MAYO-SMITH Fourth Plaintiffs
AND	RICHARD CILIANG YAN First Defendant
AND	PETER GOMM Second Defendant
AND	RT HON JENNIFER MARY SHIPLEY Third Defendant
AND	CLIVE WILLIAM CHARLES TILBY Fourth Defendant
AND	PAUL DAVID COLLINS Fifth Defendant
AND	RICHINA GLOBAL REAL ESTATE LIMITED (IN LIQ) Seventh Defendant
AND	ISOLA VINEYARDS LIMITED (PREVIOUSLY KNOWN AS WAIHEKE VINEYARDS LIMITED) (IN LIQ) Eighth Defendant

Hearing:	17–21 September; 24–28 September; 1–5 October; 8–12 October; 15–19 October; 22–26 October; 29 October–2 November; 5–9 November; 12–13 November 2018
Counsel:	M D O'Brien QC, Z G Kennedy and M D Pascariu and Y J Lee for the Plaintiffs D J Chisholm QC, T P Mullins, C I Hadlee, and R E Schultz for the First Defendant J E Hodder QC, M D Arthur and J Marcetic for the Second to Fifth Defendants
Judgment:	26 February 2019

JUDGMENT OF COOKE J

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INTRODUCTION

[1] The Mainzeal name has been associated with a significant construction company in New Zealand for many years. The first plaintiff is Mainzeal Property and Construction Ltd, now in liquidation (Mainzeal). Over the years it constructed several landmark buildings in New Zealand's cities, including Spark Arena in Auckland and the Supreme Court building in Wellington. The original company was established in approximately 1968. It was publicly listed for significant periods during its history.

[2] In 1995, an investment consortium with a focus on investments in China acquired a majority shareholding in Mainzeal's then holding company. This investment consortium was associated with the first defendant, Mr Richard Yan. The company group came to be known as the Richina Pacific group. In 2004, the group established a new independent board for Mainzeal with the third defendant, Rt Hon Dame Jennifer Shipley, as Chairperson. It operated for nearly 10 years under this board until the company collapsed in February 2013. Its collapse left a deficiency on liquidation to unsecured creditors of approximately $110 million. The unpaid creditors are sub-contractors ($45.4 million), construction contract claimants ($43.8 million), employees not covered by statutory preferences ($12 million), and other general creditors ($9.5 million). Mainzeal's secured creditor, BNZ, was fully paid out.

[3] These proceedings are brought by the liquidators, and companies in liquidation, against the former directors, effectively for the benefit of these unsecured creditors. There are a series of causes of action, but the principal claim is the Mainzeal directors breached their duties under ss 135 of the Companies Act 1993 by engaging in what is colloquially called reckless trading. In addition to Mr Yan and Dame Jenny, the relevant former directors who are sued are the former Chief Executive Officer, Mr Peter Gomm, and Mr Clive Tilby. They are the second and fourth defendants respectively. The fifth defendant, Sir Paul Collins, who joined the board as a director in the year before the company's failure, is also sued, but not on the main claim of reckless trading.

[4] At the heart of the plaintiffs' reckless trading claims is the allegation the company was insolvent as a consequence of the Richina Pacific group extracting considerable funds from Mainzeal for investment in China. Mainzeal nevertheless continued trading in an insolvent state for several years. When trading the directors relied on promises from the Richina Pacific group that financial support would be provided when needed. But such promises were not formalised, or legally binding. The ability to provide that support was also limited by stringent Chinese foreign exchange restrictions. These restrictions inhibited the Richina Pacific group's ability to repatriate funds from China when required. Mainzeal was, nevertheless, able to continue to trade by using a cash flow advantage enjoyed by construction companies — where payments made by construction contract principals are received in advance of payment to sub-contractors — effectively using this money as its working capital. The plaintiffs say that trading in this state was inappropriate, and that Mainzeal's financial performance also meant it was vulnerable to significant losses and company failure. Following a difficult period in 2012, Richina Pacific was no longer willing and/or able to fully support Mainzeal, and it collapsed. The plaintiffs say Mainzeal's failure was predictable, and a consequence of Mainzeal trading while insolvent in the manner described above. They also say that the manner in which the directors so agreed to engage in business exposed the creditors to a substantial risk of serious loss meeting the requirements of s 135.

[5] The defendants reject the allegation that Mainzeal was insolvent, or that the directors acted unreasonably by relying on Richina Pacific support. They say it is

fundamentally wrong to consider Mainzeal individually without assessing its position as part of a wider group. Richina Pacific provided very substantial financial support to Mainzeal over the years and the directors acted reasonably in reliance upon that support. Its trading performance, whilst disappointing, was not unduly concerning, and it was looking up at the times of alleged breach. It is absurd to suggest that, in those circumstances, the directors should have ceased trading at the times alleged. Mainzeal only failed because of a perfect storm of adverse factors, and notwithstanding very substantial financial investment by Richina Pacific in an effort to avoid failure. Finding the directors liable under s 135 in those circumstances would be both unprecedented and unprincipled.

[6] The other causes of action focus on particular restructuring transactions that took place in 2012, the year prior to Mainzeal's failure, which are alleged to have contributed to the extent of the loss felt by creditors. The defendants reject that, saying that the restructurings were properly motivated and caused no loss.

FACTUAL FINDINGS

[7] Although many of the key facts are not in dispute, there are important differences between the parties as to the characterisation of the facts. The evidence relevant to the claims spans more than 10 years of the operation of the company. That is so because many of the features relied upon by the plaintiffs to establish a breach of s 135 of the Companies Act arise in association with matters that occurred in the early years. It is accordingly appropriate to begin by making factual findings associated with the relevant events. In doing so, I concentrate on findings that are relevant to the alleged breach of s 135 and the key differences between the parties. I make additional factual findings when addressing the particular causes of action, including when directly addressing s 135.

The evidence

[8] The trial proceeded over the course of just over eight weeks. The evidence of fact presented by the plaintiffs came primarily from one of the liquidators, Mr Andrew Bethell, largely in the form of the documentary records of the company supplemented by opinion evidence. His evidence was further supplemented by expert accounting

evidence from Mr William Apps. A number of other experts were also called by the plaintiffs. The main evidence of fact from witnesses came from the defendant directors themselves. Each of the defendants gave evidence, as did the Chairperson of the Richina Pacific board, Mr John Walker. The defendants also called a range of expert evidence.

[9] There were objections by the defendants to some of the plaintiffs' evidence. By judgment dated 20 September 2018, I accepted that Mr Bethell could give opinion evidence,[1] and by judgment dated 5 October 2018, I dismissed the defendants' objections to Mr Trevor Burt giving corporate governance expert evidence.[2] A series of objections were also made to other parts of the plaintiffs' evidence, with the evidence being received de bene esse. In closing submissions, those objections were not pursued, but I was invited to treat the matters raised as going to weight. There was some substance to some of the points raised by the defendants, and I have not given weight to much of the evidence objected to.

[10] In closing submissions, the defendants also took issue with the way the plaintiffs had presented their case in a number of respects. Some of those points also had merit. In particular, the plaintiffs invited me to reach conclusions on certain matters of fact notwithstanding that they had not been squarely put to certain witnesses, particularly Mr Yan, contrary to the duty in s 92 of the Evidence Act 2006. I have not made findings adverse to the defendants in relation to issues where this occurred.

[11] There is one other significant feature of the evidence. Certain witnesses were not called by either side, even though it is apparent that evidence from those witnesses may have had some significance. In particular, neither the plaintiffs nor the defendants called Mainzeal's Chief Financial Officer, Mr Reegan Pearce. It is apparent from his role, and from a number of emails that he sent at the time, that he was likely to have been a significant witness of fact. In addition, nobody was called from Ernst & Young, Mainzeal's auditors over the most important period of time in issue in this case. Given the significance of their assessment of Mainzeal as a going concern, and the other

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1 *Mainzeal Property and Construction Ltd (in liq) v Yan* [2018] NZHC 2470.
2 *Mainzeal Property and Construction Ltd (in liq) v Yan* [2018] NZHC 2522.

reports to the directors provided by that firm, it is also apparent that they may well have had relevant evidence to give. The plaintiffs bear the onus of proving their case, but equally the defendants did not call such evidence to support the case that they were advancing. I do no more than note these points. I have decided the case on the evidence I have heard.

Richina Pacific's acquisition of Mainzeal

[12] As indicated, Mainzeal was in existence as a New Zealand construction company from approximately 1968. It was first listed on the New Zealand Stock Exchange in 1969, under a previous name. The name was changed to Mainzeal in 1975, then, as mentioned, the present Mainzeal was incorporated in 1987. During this period, Mainzeal's holding company, Mainzeal Group Ltd, was the publicly listed entity.

[13] In 1995, a majority share of Mainzeal Group was acquired by an investment consortium subsequently known as REH Capital Ltd, which was controlled by Mr Yan. In 1981, Mr Yan had obtained a Rotary scholarship to come from China to study in New Zealand. One of his host families was the family of Mr Peter Menzies, one of the founders of Mainzeal, and Mr Yan worked for Mainzeal during his school holidays, including by sweeping the floors of the St James Theatre in Auckland. Mr Yan subsequently became an entrepreneur with a degree from the University of Auckland in 1985, and from Harvard Business School in 1988, where he met some of his fellow investors. After working for periods at Bankers Trust in New York and Hong Kong, he established REH Capital in 1993.

[14] REH Capital comprised a group of North American individuals and entities wishing to engage in private equity investment. Mr Yan himself was one of the investors holding what was a significant personal interest. By virtue of holding non-equity shares, he also had effective control of the day-to-day management of the investments. In evidence, he described his authority as a "democratic dictatorship".

[15] Mr Yan explained that the acquisition of Mainzeal was not truly intended. REH Capital was primarily interested in investing in China. Mainzeal Group also owned Mair Astley Holdings Ltd, an entity involved in the leather industry. REH Capital's

main objective was to acquire this interest to associate it with the interests it already had in the leather industry in China. Mr Yan explained with respect to Mainzeal that "many shareholders in the Consortium didn't like the idea from the beginning, but trusted me in making the best deal for them". Sir Paul Collins, who represented another group of shareholders, explained that he was one of those who was not enthusiastic. This tension in the shareholder group remained as a significant factor right through until Mainzeal's demise.

[16] In 1996, Mainzeal Group acquired the remaining 48 per cent interest in Mair Astley, and all its New Zealand operations were merged. In September 1996, Mainzeal Group was renamed Richina Pacific Ltd. Richina Pacific Ltd was later removed from the New Zealand Companies Register in December 2003, and a new company was then incorporated in Bermuda (Richina Pacific). The Richina Pacific annual reports referred to the issue surrounding the desirability of owning a construction company in New Zealand. In the annual report for the financial year ending 31 December 2003, Mr Yan's statement as Chief Executive Officer identified one of the reasons for doing so was that it did not require much equity capital given the significant cash flows involved in the construction industry, which operated as a kind of working capital, and that the "critical factor" was how to "contain as far as possible the downside risk in this business".

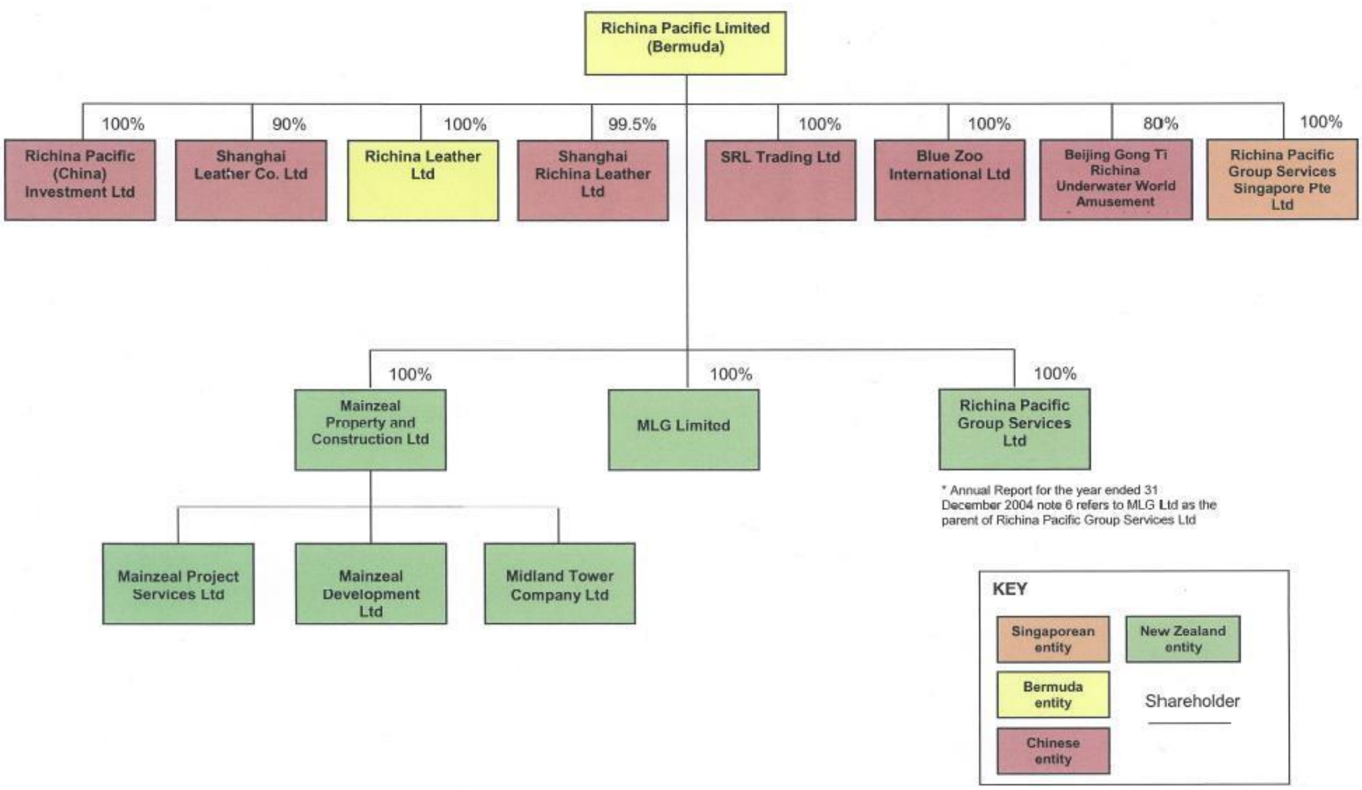
[17] Early in its operations, Mainzeal operated successfully. There was some evidence of a substantial dividend being paid by Mainzeal to Richina Pacific in 1999, but the evidence was not clear on the point and it was not pursued by the plaintiffs with Mr Yan, so I make no findings in relation to that suggestion. There was also evidence of a later investment in Mainzeal by Richina Pacific. In particular, in 1995 and 1996, Richina Pacific had raised funds to make further investments in China, but a situation emerged when the developer of the Mobil on the Park project in Wellington, over which Mainzeal was the construction contractor, was unable to complete the project. Richina Pacific invested $37.4 million in Mainzeal to enable it to complete the project itself. The building (now known as the Dimensions Data Tower) was developed, and subsequently sold at a profit. Mr Yan said in evidence that the $37.4 million was subsequently returned to Richina Pacific (and other entities in the group)

in the form of loans. The contemporary documents leave me with considerable uncertainty about the extent of the investment and what Mainzeal retained, however.

Establishment of Independent Board in 2004

[18] In April 2004, a new independent board was established for Mainzeal. Mainzeal was wholly owned by Richina Pacific, which, as mentioned, was by this stage incorporated in Bermuda. Richina Pacific was, however, registered as an overseas company under Part 18 of the Companies Act and publicly listed on the New Zealand Stock Exchange. The investment consortium represented by Mr Yan continued to own 51 per cent of the publicly traded shares.

[19] The constitution adopted for Mainzeal in June 1996 contained provisions contemplated by s 131(2) of the Companies Act, allowing a director of a wholly-owned subsidiary to act in the best interests of its holding company, even when that may not be in the company's best interests. The overall group structure was complex. In 2004, the structure was as follows:



[20] Dame Jenny became the Chairperson of the newly established board and Mr Tilby became a director. Dame Jenny was also a director of Richina Pacific. Mr Yan was a director of both Richina Pacific and Mainzeal at this stage, although he resigned as a director of Mainzeal in November 2004. In 2006, he and his family came to live in New Zealand and he became a Mainzeal director again in April 2009. Dame Jenny explained that she had been approached in late 2003 or early 2004 by Sir Allan Wright, who was on the board of Richina Pacific and Mainzeal at the time. He introduced her to Mr Yan and she agreed to go on the boards of Richina Pacific and Mainzeal, and to take over as Chairperson of the Mainzeal board. Mr Tilby explained that he had been approached by Mainzeal's then Chief Executive Officer, Mr Ranford, to go on the board. Mr Tilby was a consultant with significant governance experience in the construction industry.[3]

[21] By letter dated 19 March 2004, the company secretary of Richina Pacific, Mr Warwick Lobb, sent the then directors what came to be known as the "Charter", which was a document established to formalise the relationship between Richina Pacific and Mainzeal. The Charter contemplated the application of s 131 of the Companies Act. It is accordingly a document of significance. One of the key paragraphs provided as follows:

> AUTHORITIES:
>
> The appointed Board of MPC will have the authority and obligation to do such things as are necessary to ensure appropriate governance in the best interests of the Company and, if directed, the Parent, as permitted by law and the Constitution, except as to matters involving:
>
> - equity raising
> - capital expenditures (in excess of limits to be from time to time agreed)
> - appointment and remuneration of CEO and CFO
> - taxation matters
> - dividends and loan account to/from the parent and its subsidiaries

[3] Mr Gomm joined the board later. He was also experienced in the construction industry. He joined Mainzeal as Chief Operating Officer in May 2007. He then became Chief Executive Officer in April 2009, and joined the board in June 2009.

> In respect of matters for which no direct authority is provided, the Board is expected, from time to time, to make representations/recommendations to the [Richina Pacific] Board on these matters, which the [Richina Pacific] Board, in its absolute discretion, may approve or reject, with or without explanation.

[22] The new board members of Mainzeal had their inaugural board meeting on 13 April 2004, the minutes of which were received at an Richina Pacific board meeting on 20 April 2004. At that Richina Pacific board meeting, Dame Jenny sought comments and direction in relation to the Charter, and the relationship between Richina Pacific and Mainzeal. As a consequence, by letter dated 10 June 2004, Mr Lobb wrote to the directors of Mainzeal, on behalf of Richina Pacific, providing further details about the relationship. This letter provided further concrete advice. In it Mr Lobb advised, amongst other things:

> 10. Within any [Richina Pacific] policy, [Mainzeal] should determine its own policies and procedures to best utilise the equity it has, plus from time to time new equity it has been allocated by the [Richina Pacific] board. To the extent that it requires more capital, it will have to compete with other demands from other subsidiaries or from initiatives within the [Richina Pacific] corporate group. Allocations may need to be made, and if that is the case, the basis would be need, and expected return on investments. [NB: Any safety, health and environmental issues usually need to take precedent and be fixed first- these also being matters on which each director can be personally liable.] The Directors of the [Mainzeal] board who are also on the [Richina Pacific] board would be expected to promote any reasoned requests for equity at the [Richina Pacific] board level once they are satisfied as to the appropriateness of those requests, and funding cannot otherwise be secured.

[23] At the Mainzeal board meeting on 28 June 2004, Dame Jenny recorded that the general principles of Mr Lobb's letter were understood and accepted.

[24] The terms of the Constitution, Charter and the explanatory letter are tolerably clear. Richina Pacific had the ultimate power as the owning shareholder, particularly in relation to equity and in relation to loans to and from Mainzeal. It had certain expectations, which it could enforce by the power to require Mainzeal to comply with certain policies, including in relation to returns to the shareholder. There could be no promise of any new equity, and Mainzeal would have to compete with the wider group's competing interests in that respect. But the "backing" of the Richina Pacific was evident, and its accounts could be used to help Mainzeal obtain business.

Funds extracted from Mainzeal

[25] Between 2004 and 2005, these arrangements were utilised for the benefit of the Richina Pacific group. This was particularly so with respect to a major acquisition made by the group in China of the Shanghai Leather Co Ltd (SLC), a former Chinese Government-owned company that had extensive land use rights in Shanghai.

[26] Mainzeal contributed funds to assist Richina Pacific with this purchase. An advance was made by Mainzeal to MLG Ltd (MLG), a New Zealand company that was also owned by Richina Pacific. A facility called a "floating rate debenture loan" between Mainzeal and MLG was used. The loan document stated that the loan was to be repayable in seven years' time, together with interest accruing and capitalising at 10 per cent of the consolidated profit of SLC. Clause 8 of the loan document recorded that Mainzeal's claim ranked equally with unsecured creditors. The amounts borrowed by MLG were further transferred within the wider group to acquire the assets. Mainzeal directors took no independent legal advice in relation to the entry of this loan.

[27] Mainzeal's loan to MLG was for USD 2.37 million. These funds were part of the funds used by the Richina Pacific group to acquire SLC, which had a total purchase price of USD 20 million. The loan from Mainzeal to MLG to allow the acquisition to proceed contributed approximately 10 per cent of the acquisition price. The acquisition of SLC was an enormously significant transaction. Mr Yan's statement as Chief Executive Officer in Richina Pacific's 2004 annual report recorded that "2004 will be recorded in history of Richina Pacific Ltd (RPL) as the pivotal turning point for its future success", and he compared the acquisition of SLC to the Louisiana Purchase. This was because, by purchasing SLC, Richina Pacific purchased substantial land use rights around Shanghai, which became very valuable property as the city expanded. Mr Yan was most reluctant in cross-examination to place a present-day value on this holding, including because it is not truly tradeable. At one point, reference was made to the land being worth 148 times its acquisition price. It was suggested to Mr Yan in cross-examination that it would now be worth more than USD 700 million. He did not accept that, but did not indicate any alternative figure in response. It is plainly a very valuable holding.

[28] The interest calculation for the MLG loan was based on SLC's profit. As Mr Yan accepted in cross-examination, that profit calculation would not include any assessment of the increase in underlying value of the land use rights. It is the substantial increase in the value of the land use rights that provided very considerable financial advantage to Richina Pacific. The interest calculation did not capture that.

[29] A second facility agreement between Mainzeal and MLG was entered on 15 November 2005. This current account loan earned interest at 9.5 per cent, repayable at dates in 2006. A Mainzeal internal memorandum of 28 October 2005 records a request from Richina Pacific for Mainzeal to loan USD 5 million to MGL to allow Richina Pacific to acquire a further subsidiary associated with SLC, known as Shoe No 1 Company — a company in Shanghai manufacturing shoes. Although Mr Yan denied that Mainzeal funds were used for this purpose, the records speak for themselves. Mr Yan explained that this company was acquired for one yuan (approximately 18 cents at the time) so that no such funding was required. But Shoe No 1 Company came with extensive liabilities that had to be met, meaning that funds were needed in connection with the purchase. So it seems apparent that Mainzeal was again assisting Richina Pacific in acquiring substantial assets in China. Again, no independent legal advice was taken on the entry of this further loan agreement.

[30] It is also apparent that other funds were extracted from Mainzeal by Richina Pacific. The minutes of the Mainzeal board meeting on 7 December 2004 spoke of Richina Pacific extracting money for working capital requirements. By 31 December 2005, MLG's debt to Mainzeal was NZD 3.47 million under the floating rate debenture loan, and NZD 16.79 million under the current account loan. This latter figure demonstrates that considerable additional extractions were involved. The operating arrangements were accordingly being implemented to the considerable advantage of Richina Pacific.

[31] It is significant that whilst the funds were being used by Richina Pacific itself to obtain significant assets in China, MLG was being used as the borrowing party. Whilst it was suggested by the defendants that this arose because MLG was used as a funds transfer vehicle, and may have been inserted for tax reasons, using MLG meant that Richina Pacific itself had no legal liability to repay. Neither did MLG have the

ability to itself repay the loans. Using MLG also necessitated a further legal mechanism to transfer the monies from MLG to Richina Pacific. The MLG accounts for the financial year ending 31 December 2005 record that MLG bought back shares from Richina Pacific for NZD 19 million. Such legal complexities suggest care was being exercised in forming the legally binding arrangements. The care taken with the legal form of the arrangements between Richina Pacific and Mainzeal is another important feature of the background.

Initial period of operations

[32] Richina Pacific nevertheless provided Mainzeal substantive support for its ongoing operations. Significant construction contracts of the type Mainzeal engaged in sometimes had a requirement that a "construction bond" be provided. A construction bond is an instrument that the contractual principal can call upon if the construction company fails to perform its obligations. The bonds are usually issued by a significant institution, usually a bank or an insurance company, and are for a percentage of the total construction contract price — usually 10 per cent. Mainzeal's bond provider — referred to as a "bondsman" — was often Vero Insurance. Institutions such as Vero require the bonds to be backed up by a guarantee from a party of substance. So, before bonds could be issued on some of Mainzeal's construction contracts, a guarantor of substance needed to be found. Richina Pacific provided this guarantee for Mainzeal's construction bonds, and also sometimes provided the construction bond itself. Whilst this did not involve Richina Pacific actually providing funds, it did involve it accepting significant contingent liabilities.

[33] The operating structure largely continued for the following three years except that a new company, then called Richina Land (NZ) Ltd, but which subsequently came to be known as Richina Global Real Estate Ltd (RGREL), was introduced as Mainzeal's immediate holding company in 2006. This also appears to have arisen as part of the carefully adopted legal structures. The Richina Pacific group also used RGREL as a vehicle to extract funds from Mainzeal, although the main extractions appear to have commenced before the establishment of the independent board in 2004. Although RGREL was of greater financial substance than MLG, neither were in a position themselves to repay the Mainzeal loans.

[34] Mainzeal's financial performance at this time was poor with a loss for the financial year ending 31 December 2005 of $7.5 million compared with a profit of $4.2 million the previous year. In the Richina Pacific six-month report for the first half of 2005, Mr Yan advised that "clearly more investment of capital and time … will make little economic sense". The performance was much improved for the financial year ending 31 December 2006, with an operating profit before tax of $14.8 million. It is notable, however, that $7 million of that profit was attributable to the Mobil on the Park project. For the financial year ending 31 December 2007, the performance deteriorated, with a normalised profit of $5.1 million recorded, but with interest of $2.85 million from the intercompany loans contributing to that profit. The accounts recorded that by this time Mainzeal was owed very significant amounts by Richina Pacific entities totalling $39.4 million, involving $14.7 million owed by RGREL, and $24.7 million owed by MLG. There is no evidence identifying what specific use was made by the group of the funds borrowed by RGREL, or whether they were used to acquire assets in China.

[35] The loans to MLG and RGREL, and the "receivables" from MLG and RGREL, appeared in Mainzeal's accounts as an asset. They were accordingly significant. The audited accounts of MLG for the financial year ending 31 December 2008 recorded that MLG had negative equity of $44.845 million. The two directors of MLG were Mr Yan and Dame Jenny. It is clear that MLG was not in a position to repay the loans to Mainzeal. Its audited accounts contained the statement that "Richina Pacific Limited has undertaken measures to provide financial assistance to the company, if necessary, to ensure that the Company will meet its debts as they fall due". In the absence of such support, both MLG and Mainzeal were apparently insolvent. In particular, if the loans by Mainzeal to MLG and RGREL could not be recovered, Mainzeal's liabilities would have significantly exceeded its assets.

[36] Richina Pacific had also provided formal letters of support for Mainzeal itself in connection with Mainzeal's audited accounts. By letter dated 7 May 2008, Richina Pacific provided such a letter for a minimum period of 12 months from 7 May 2008. No promise to provide such support was recorded in the Charter or the accompanying letter, but it was a key aspect of the relationships at the time. Given the extraction of funds from Mainzeal, such a letter of support became necessary to ensure that

Mainzeal remained classified as a going concern for the purposes of the annual accounts under the New Zealand Accounting Standards.

[37] There is authority that such letters of comfort, particularly when provided in connection with an annual audit, are not legally enforceable.[4] That was because they did not exhibit an intention to create legally binding relations, or provide an enforceable undertaking or guarantee. There can be room for argument on the enforceability of such documents in particular cases — particularly in the New Zealand context, with greater capacity to sue for misrepresentation, including under the Fair Trading Act 1986. In the present case, however, it was not contended before me that the letters of support given by Richina Pacific entities were legally enforceable.

[38] The fact that some care had been taken for Richina Pacific itself not to face legal responsibility for repayment of the loans is partly explained by the circumstances of Richina Pacific's investment in Mainzeal. As indicated, the requirement for it to act as the provider or guarantor of the construction bonds was a significant commitment. There are a number of contemporaneous documents suggesting at least ambiguity amongst some of the shareholders relating to their enthusiasm for the Mainzeal investment. I accept Mr Yan's evidence that he remained personally supportive of the Mainzeal investment. But in doing so he had to manage his relationship with his investors, who were not all as enthusiastic. The lack of any legally binding commitments beyond those required for the construction bonds was a consequence.

Chinese regulations

[39] There is a further factor of significance relating to these arrangements. There were very stringent foreign exchange controls exercised by the Chinese governmental authorities and particularly the State Administration of Foreign Exchange (SAFE). The official currency of the People's Republic of China is the renminbi (RMB).

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4 See *Kleinwort Benson Ltd v Malaysia Mining Corp Bhd* [1989] 1 WLR 379 (CA); *Carillion Construction Ltd v Hussain; re Simon Carves Ltd* [2013] EWHC 685 (Ch); *Bank of New Zealand Ltd v Ginivan* [1991] 1 NZLR 178 (CA) at 180; and *Genos Developments Ltd v Cornish Jenner & Christie Ltd* HC Auckland 10 July 1990, CP 556/90.

During the relevant period, one yuan (the base unit of RMB) was worth approximately 17– 29 cents. There were very tight controls on removing money from China — that is on buying foreign currency with RMB. The rules in this respect changed over the course of events in this case. A number of witnesses addressed the issue, including two Chinese law experts (Mr Lingyun He for the plaintiffs and Mr Lijun Cao for the defendants), as well as Mr Charles Finny, an expert in New Zealand/China relations called by the plaintiffs. The matter was also addressed by Mr Yan himself.

[40] A number of techniques were used to allow money to leave China, but they had significant limitations. Chinese authorities could allow Chinese companies to acquire businesses overseas, but the expert evidence was that the authorities were unlikely to support money being used for failing enterprises. Other techniques were used in this case, as I will explain below. The important point is that once funds had been extracted from Mainzeal and used to make investments in China, it was difficult to get the money back out again, even though the assets acquired increased considerably in value.

[41] In summary, Richina Pacific had extracted considerable funds from Mainzeal. This had been done to help secure assets of considerable value in China. It had done in the form of loans, which allowed the loans to be recorded as assets in Mainzeal's accounts. The substantial assets that had been purchased with this money were not themselves held by the borrower, and the borrower itself had limited ability to repay the loans. In any event, there would be considerable difficulty in getting funds out of China. If the loans were not recoverable, then Mainzeal was apparently insolvent. A promise of assistance from Richina Pacific was, nevertheless, provided. This was treated as providing the necessary support for Mainzeal to continue as a going concern. But it was not suggested that the promise was legally enforceable. This is the beginning of the dependence upon non-binding assurances of support that are of central importance to this case.

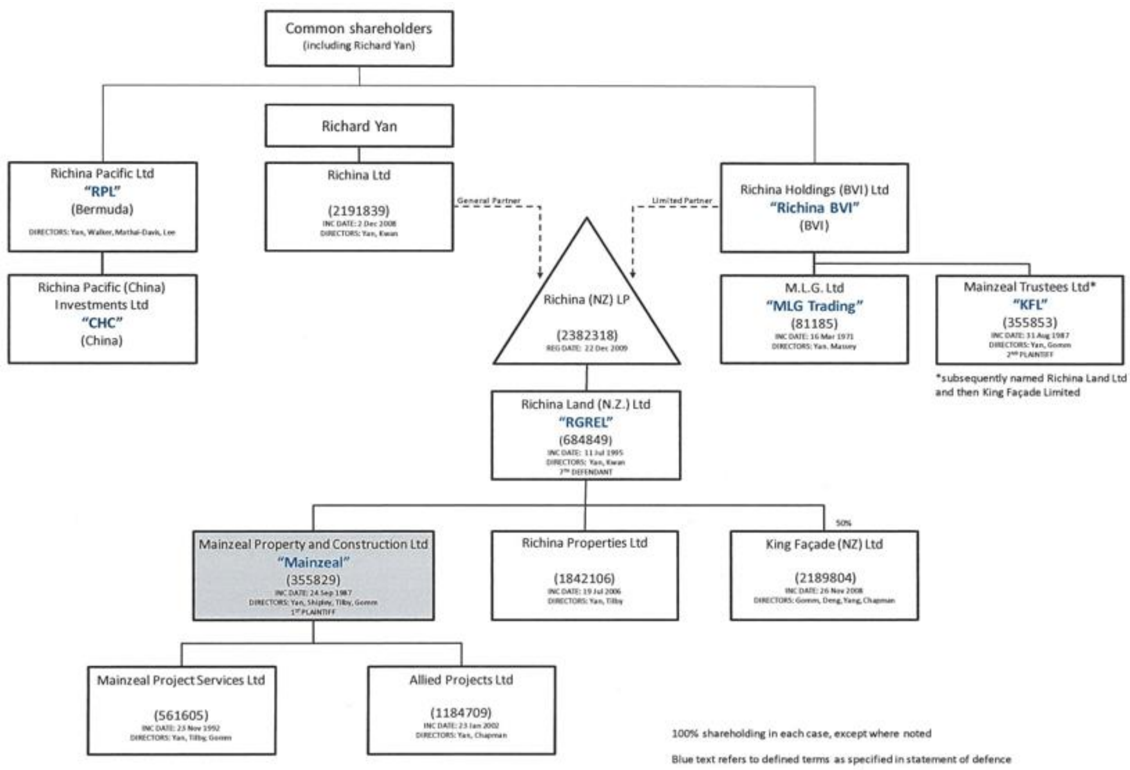
2008-2009 restructuring

[42] There was a wider restructuring of the Richina Pacific group in 2008 and 2009. Mr Yan explained that it arose from the differences of view amongst the shareholders

in relation to the investments held by Richina Pacific. Some did not want to have investments in New Zealand, particularly in a construction company. They wished to concentrate their investments in China. Others were more interested in the New Zealand investment. Mr Yan said that the point of the overall restructuring of the Richina Pacific group was to divide it into separate divisions, with the shareholders then having a choice as to where they wished their investments to be. In essence, this separated out the New Zealand companies from the Chinese companies, although the original plan was for there to be four divisions. Richina Pacific would delist from the New Zealand Stock Exchange, and buy back the publicly listed shares.

[43] The arrangements were set out in an investment statement sent to the public shareholders. A new Richina Pacific entity would be created as a private company, which would no longer be the ultimate holding company of Mainzeal. New entities were to be used as holding companies of a New Zealand division, including Richina (NZ) LP, which would own RGREL.

[44] The restructuring commenced in late 2008, including with the delisting of Richina Pacific. It ultimately did not proceed as fully as first intended and was not completed until late 2009. Following completion, the new structure was as follows:



[45] The relationship between Mainzeal and Richina Pacific, and the Richina Pacific subsidiary that held the substantial assets, Richina Pacific (China) Investments Ltd (CHC), was now more remote. It is also significant that Richina Pacific delisted from the New Zealand Stock Exchange. It was now just a private company incorporated in Bermuda.

[46] The 51 per cent holding that REH Capital had in Richina Pacific increased as a consequence of the de-listing and acquisition of minority shareholdings. It increased to something in the order of 70 per cent as the public shareholdings were acquired. Mr Yan's personal equity interest in Richina Pacific also increased. The evidence was not entirely clear as to what his personal interest became, but it at least increased to approximately 25 per cent. He also had effective control by virtue of his control of REH Capital.

[47] As part of the separation of the Chinese and New Zealand divisions, it was proposed that Mainzeal be capitalised so that it could operate independently of Richina Pacific. By letter dated 21 November 2008, Richina Pacific's auditors, PricewaterhouseCoopers (PwC), provided a report on the then proposed restructuring and delisting. In it, PwC advised:

> **The New Zealand Division**
>
> 15. The New Zealand Division will essentially comprise Mainzeal. Mainzeal's balance sheet is in a deficit position (excluding its intercompany advance) and it requires the support of the [Richina Pacific] Group to operate in the short term. Consequently, to enable it to operate as a stand-alone division, it requires a cash injection from the Group. We are advised that this will be affected through the issue of preference shares by the Investments Division to the New Zealand Division which are intended to qualify for treatment as equity of the Richina Land (NZ) Limited and the New Zealand Division. Following the investment in preference shares, it is intended that the New Zealand Division will be able to operate independently from the remainder of [Richina Pacific].
>
> 16. The issue of preference shares should be undertaken prior to amalgamation and be sufficient to deal with Mainzeal's deficit.

[48] The investment statement issued to the shareholders recorded that the value of the preference shares would be USD 13.5 million. That amounted to approximately half of what was then owed to Mainzeal by the Richina Pacific entities. The

investment statement also advised the shareholders that "[Richina Pacific] will ensure that each Division is appropriately capitalised …".

[49] The Mainzeal board were aware that Richina Pacific was not intending to capitalise Mainzeal by other means, and that there was a solvency issue given the state of the recoverability of the intercompany loans. The January 2009 report to the Mainzeal board from the Chief Financial Officer, Mr Reegan Pearce, stated:

> It is not anticipated that any further cash support will come from the [Richina Pacific] parent directly to Mainzeal other than potentially a cash injection to the new parent of the NZ division as disclosed in the [Richina Pacific] notice of meeting to get to a solvent position.

[50] This note is significant as it reflected the substantive position. The proposed capital injection was necessary to get Mainzeal to a solvent position.

[51] This capitalisation never ultimately took place, however. The redeemable preference shares were issued, but never called up. As a consequence, the capital injection that PwC had advised was necessary for Mainzeal to operate as a standalone division in the short term, and to address Mainzeal's balance sheet deficit, never occurred, and separation did not proceed as fully as initially intended.

[52] One of the key reasons why it did not proceed was that the parties who were providing the construction bonds on Mainzeal's construction contracts did not accept a substitution of RGREL for Richina Pacific as guarantor of the construction bonds even if RGREL was capitalised as proposed. Mr Yan explained that the bondsman, Vero, indicated that it would be necessary for RGREL to have more capital than the USD 13.5 million (equivalent to approximately NZD 20 million at that time) for it to be acceptable. Vero advised that any New Zealand entity replacing Richina Pacific would have to have capital of NZD 40 million — that is, approximately the level of the intercompany loans.

[53] Mr Yan explained that the figure of $20 million had originally been recommended by PwC. This figure had been obtained because a United States investor had asked how much capital was required to separate the New Zealand and Chinese assets. He had been prepared to provide that capital to ensure the separation.

But Mr Yan also explained the global financial crisis in 2008 intervened, and the investor was not able to provide the funds. In any event, the PwC assessment of what was required was not sufficient given Vero's stance.

[54] Richina Pacific decided against capitalisation in these circumstances. The minutes of the audit and governance committee of Richina Pacific for 26 May 2009 record that Richina Pacific "determined that it would not be prudent to put [USD] 13.5 million cash in Richina Land in order to create a cash positive stand-alone entity". As a consequence, the more extensive separation did not proceed. The amalgamation that created a new Richina Pacific was completed, but the shareholders of Richina Pacific did not make the choice as between divisions. Instead, they all continued as shareholders of both Richina Pacific, which ultimately owned the Chinese investments, and Richina Holdings (BVI) Ltd, which ultimately owned the New Zealand investments in a limited partnership with an investment company owned by Mr Yan.

[55] The Mainzeal directors were generally aware of the significance of the separation, even in its more limited form, and the greater independence contemplated. As mentioned, Mr Yan re-joined the Mainzeal board in April 2009. The minutes of the board meeting on 28 April 2009 record:

> **3.7 Bonding Availability** RP/RY
>
> Note – Generally positive meeting held with the Bondsman based on RY's representation that [Richina Pacific]'s support will be ongoing. The Bondsman is seeking the group's consolidated audited accounts for 2008 and ongoing 2009 MZL management accounts.
>
> **3.7 Support of Mainzeal by Richina Pacific Limited**
>
> RY reaffirmed that the support of Mainzeal is ongoing, however the directive is for Mainzeal to be self-sufficient and to grow to become a much stronger stand-alone viable entity.

[56] This was reported to the Richina Pacific board in the following terms the following month:

> The principles of operation now adopted by the Mainzeal senior management team, is that Mainzeal is a standalone business entity which has to be financially self-sufficient from [Richina Pacific]. There is one exception, the need for the [Richina Pacific] Parent Company Guarantee to support the availability of performance bonds from Vero required by the typical New Zealand public and private clients.
>
> [Richina Pacific] has confirmed that consistent with this mandate, Mainzeal will retain all profits and cash-flow to rebuild the company's balance sheet and net worth.

PricewaterhouseCoopers concerns

[57] One of the auditors who authored PwC's initial advice addressing the need to capitalise Mainzeal, Mr Michael Schubert, gave evidence. He explained that the failure to capitalise the New Zealand division as indicated in the information provided to the public shareholders of Richina Pacific caused him considerable concern. An associated promise to provide greater financial disclosure following delisting, particularly concerning the related party transactions, also did not occur, which also concerned him.

[58] On 22 May 2009, PwC raised its concerns in the draft audit report for Richina Pacific for the financial year ending 31 December 2008. This letter raised the fact that the redeemable preference shares had not been called upon, and that the greater transparency concerning related party transactions had not occurred. PwC also raised an issue as to whether Richina Pacific itself was a going concern. A response from Mr Walker recorded the concern in the following terms in relation to a loan from Siam Commercial Bank to Richina Pacific:[5]

> PwC has raised the question of whether [Richina Pacific] is a going concern, specifically with respect to the ability of [Richina Pacific] to access funds to support its non-China entities, particularly Mainzeal, and to repay the loan from Siam Commercial Bank ("SCB") when due.

[59] The letter from Mr Walker responded to the PwC concerns. It stated that Richina Pacific did not plan to subscribe for the shares until the restructuring was completed. Mr Schubert also explained that advice was obtained from Russell McVeagh in light of his concern that the suggested failures involved a breach of

5 PwC's original letter and report is no longer in existence, and only a draft of this reply has been found. But Mr Schubert confirmed it was similar in terms to the final letter.

securities laws arising from what had been represented to the public shareholders. He said that Russell McVeagh advised that there was no such breach. He said that this was accepted, and that ultimately PwC signed off the audit reports.

[60] Mr Schubert nevertheless said that he lost confidence in his ability to rely on assurances given to him by Mr Yan, and that he "also lost confidence that the boards of [Richina Pacific] and Mainzeal were readily able to impose any constraint on the decisions made or authority exercised by Mr Yan, despite Dame Jenny also being a director on both [Richina Pacific] and Mainzeal boards". I accept his evidence that he lost confidence. He said he was grateful when PwC was subsequently advised by Mr Walker that they would no longer be required as auditors. Messrs Walker and Yan disagreed that that was Mr Schubert's view at the time, but I have no reason to doubt it.

The post-delisting arrangements

[61] Dame Jenny stepped down from the Richina Pacific and MLG boards in late 2009. She explained that the delisting and separation of divisions was underway and that, in that context and given her other commitments, she agreed with Messrs Yan and Walker to resign from the boards of Richina Pacific and MLG, but stay on the board of Mainzeal.

[62] MLG's audited accounts for the financial year ending 31 December 2008 showed it remained effectively insolvent — it had negative equity of $44.8 million. This included owing Mainzeal $28.6 million, and RGREL $9.4 million. Notwithstanding this, Dame Jenny stated that she regarded Mainzeal's receivable from MLG as "sound". The basis for this was the expectation, recorded in MLG accounts, that Richina Pacific had "undertaken measures to provide financial assistance to the company, if necessary, to ensure that the Company will meet its debts as they fall due".

[63] By the end of 2008, the total balance of the advances made by Mainzeal to the Richina Pacific entities was $39.4 million. It would appear that the extent of the movement of funds had not been fully reported to the Mainzeal directors, however. At the board meeting in July 2009, Dame Jenny requested a regular record of payments being made from Mainzeal to other Richina Group companies to ensure "full

transparency". Prior to that it does not appear that the advances had been monitored in this way.

[64] Dame Jenny was aware that Richina Pacific and Mainzeal had come under close scrutiny from PwC, and that PwC looked very closely at the issues surrounding their going concern status. She referred to Mr Pearce conducting a worst-case cash flow analysis at the time. Mr Pearce's analysis showed that on a worst-case scenario Mainzeal could still operate within its banking limits through to June 2010. Dame Jenny said in evidence that there was "no question that Mainzeal was reliant on its parent in balance sheet terms" and that Mr Yan and Richina Pacific were "open and clear with Mainzeal directors and demonstrated to the Mainzeal directors' satisfaction that the parent company could and would support Mainzeal". This is a continuation of the expressions of support relied upon by the directors.

[65] There is no actual evidence of relevant letters of support provided by any Richina Pacific entity in 2009 for the benefit of Mainzeal, MLG or RGREL. As a consequence of the restructuring in 2008 and 2009, MLG was no longer a wholly-owned subsidiary of Richina Pacific. The period covered by Richina Pacific's letter to Mainzeal of May 2008 ended in May 2009. As mentioned, Mainzeal's audited accounts for the financial year ending 31 December 2008 were signed off by the directors and by PwC in June 2009. PwC did not provide any qualification or note of the kind that subsequently was provided in the later years when Ernst & Young took over as the auditors.

[66] Both the PwC formal advice and Mr Pearce's report to the board in January 2009 recorded that, in the absence of new capital being provided after the separation, Mainzeal was balance sheet insolvent. When this was put to the directors in cross-examination they explained that that is not how they saw it, as Mainzeal was part of the wider group, and the wider group had repeatedly provided assurances of support.

[67] Mr Gomm also explained that balance sheet solvency did not concern him because Mainzeal always had the cash flow to pay its debts. This is a result of the aforementioned feature of construction companies, particularly construction companies of a significant size. Such companies can, and do, arrange their

commitments so that they are paid significant amounts from their principals (the parties with whom they contract to engage in construction), with a delay before the sub-contractors are paid. These can be very significant amounts of money moving through a construction company's books. These acted as a kind of working capital for Mainzeal, and had been described in Richina Pacific's annual reports to its shareholders as an advantage of a construction company of this kind.

[68] The fact that the proposed redeemable preference share capitalisation had not proceeded does not appear to have been regarded as a matter of concern for the Mainzeal directors. The issue of balance sheet solvency remained, however. A Mainzeal board report in October 2009 stated:

> **Tax Defeasance and Review**
>
> A "scaled down" version of this is now being agreed with EY with one of the resulting outcomes being to move "paper equity" into the NZ division (and out of the China division) which will assist with the technical solvency issues the division currently faces.

[69] The reference to "paper equity" involved an agreement dated 28 October 2009 whereby CHC agreed to transfer to RGREL 90 per cent of the shares in Kunshan Richina Hotel Co Ltd, a company incorporated in China that owned land use rights for a proposed hotel development. RGREL was to pay CNY 74,215,860 for the shares. That transfer was conditional on relevant Chinese authorities, including "Kunshan Foreign Trade and Economic Cooperation Bureau", approving the sale.[6] It appears clear that this step was taken to make RGREL's balance sheet appear stronger. But the approval of the Chinese authorities was neither given nor sought, and the transaction was cancelled in October 2012. It appears clear that the RGREL balance sheet was not improved in a substantive sense.

[70] Other steps were taken to improve the appearance of the balance sheet. The subscription agreement for the redeemable preference shares between RGREL and Richina Pacific dated 28 November 2008 remained in existence. The agreement was never cancelled but instead Richina Pacific's obligations under it were assigned first to Richina Holdings (BVI) Ltd, and then from that company to Richina (NZ) LP. The

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6 The original transaction documents are in Chinese, but certified translations were provided to the Court.

shares were recorded in RGREL's accounts for the 2009–2011 years. Whilst the value of the shares was not taken into RGREL's balance sheet, the accounts nevertheless recorded that RGREL had the right to call on the subscription agreement. Mr Walker was surprised by these steps when he gave evidence. He thought that these shares should simply have been cancelled. The plaintiffs contend that the redeemable preference share rights remained recorded in RGREL's accounts for the 2009–2011 years in order to make it appear that RGREL had a stronger balance sheet than it in fact had. I accept that. There is no other reason to explain why the redeemable preference share rights were subject to assignments, and then recorded in RGREL's accounts for three years. This must have been to present a positive picture. As Mr Walker said, the redeemable preference shares had become irrelevant following the decision made in 2009 to not proceed with this capital funding.

[71] Mainzeal's audited accounts to 31 December 2009 were finalised in May 2010. They continued the statement that the shareholders of RGREL had undertaken to provide financial assistance to ensure that Mainzeal would meet its debts as they fell due. Ernst & Young's auditors' report dated 31 May 2010 stated:

> **Emphasis of matter**
>
> We draw attention to Note 15 of the financial statements which describes the continued support of the shareholders of Richina Global Real Estate Limited, the immediate parent company. The financial statements have been prepared on the going concern basis, the validity of which depends upon the continued financial support by the shareholders of the immediate parent company. The financial statements do not include any adjustments that would result should the support of the shareholders of the immediate parent company be discontinued. Our opinion is not qualified in respect of this matter.

[72] The letter of support was now from Richina (NZ) LP, signed by Mr Yan as "Director for the General Partner, Richina Limited". It acknowledged to the directors of Mainzeal and RGREL that Richina (NZ) LP accepted responsibility for providing, and undertook to provide, sufficient financial assistance as and when it was needed to enable them to continue operations and fulfil all financial obligations "now and in the future", with the undertaking "provided for a minimum period of twelve months from May 31, 2010". The wording was the same as the previous letter provided by Richina Pacific itself. As previously indicated it was not contended that such letters were legally enforceable. But in any case, this new entity did not have the resources to meet

the assurance of support that the letter provided. In addition, MLG, which owed Mainzeal very significant sums, was balance sheet insolvent and was no longer owned by Richina Pacific.

[73] Mr Yan gave evidence that the change in identity of the company providing the letter of support from Richina Pacific to Richina (NZ) LP was as a consequence of Ernst & Young's advice as auditors. That appears consistent with comments in the Ernst & Young audit results for the financial year ending 31 December 2009. Nobody from Ernst & Young was called as a witness by either the plaintiffs or the defendants, however.

[74] The issues surrounding the separation of the Chinese and New Zealand divisions was a matter of ongoing assessment in 2009. The new group structure proposal was explained to the directors at the Mainzeal board meeting on 30 July 2009. There does not appear to have been any discussion of the proposed capitalisation at this time.

[75] In summary, following the 2008 delisting of Richina Pacific and the restructuring completed by the end of 2009, including the separation out of the Chinese and New Zealand divisions, Mainzeal remained balance sheet insolvent. It had very significant loans to entities that were now part of the New Zealand division. These loans were not backed up in a legally enforceable way by Richina Pacific, which was now in a more separate Chinese division. The initially promised redeemable preference share capital was not provided. The shareholder letter of support and guarantee formerly provided by Richina Pacific was no longer provided by that entity. Such letters of support were now only provided by holding companies in the New Zealand division.

[76] Given these factors, it would be fair to say that from the end of 2009 Mainzeal was in a vulnerable position, and that it depended for its solvency on informal expressions of support. Notwithstanding these significant changes, Dame Jenny gave evidence that she remained confident. This was because of the verbal expressions of support that had been given, particularly by Mr Yan. She said:

> 94 Richard Yan and John Walker made clear to the Mainzeal directors that the restructure did not change the group's support of Mainzeal. At no stage was there any conversation, or any indication, that group support was no longer available. I pressed John and Richard on this point extensively at various times and they confirmed to me that until such time as the NZ limited partnership and the future New Zealand group had sufficient assets in a balance sheet of its own (including the proposal for a proposed new arm of the group, holding a banking licence in New Zealand, which went on to be called Richina Finance), the directors could completely and utterly rely on the support of the group. …

2010: Issues of concern raised

[77] The Mainzeal board met in both January and February 2010. The minutes for the 16 February meeting record that the issues arising from the restructuring were raised. After addressing the issue of whether Richina Pacific would continue to provide the bonding support, the minutes record the following question:

Who's overall duty is it to make sure that the NZ division is operating while solvent going forward, Directors of Richina Holdings (BVI) Ltd? JS/CT to seek a briefing from RY on what are the financial obligations, reporting or otherwise of the NZ division and Mainzeal.	JS/CT/RY

[78] The initials to the right indicate that the issue was to be followed up by Dame Jenny, Mr Tilby, and Mr Yan. Following the meeting, Dame Jenny duly began following up these issues. In an email dated 19 February 2010 to Messrs Yan and Walker concerning the New Zealand separation, she requested a formal response to the issues so that "we can all be clear about our roles and responsibilities". This included her saying:

> Mainzeal Directors wish to clarify who's overall duty is it to make sure that the NZ division is operating while solvent going forward on who are the Directors who carry this obligation? Both Clive and I feel we need a full understanding of this in terms of meeting our legal obligations.

[79] That email also referred to the need to confirm which accounts would be presented to customers to confirm financial strength and that there was a need for a full understanding between the boards of Richina Pacific and Mainzeal "so that all directors are aware of their obligations".

[80] Mr Walker responded by a short email the following day saying that these issues would be fully addressed, and that they were top of his agenda. No substantive

response was provided at this time, however. Messrs Walker and Yan gave evidence that they became distracted in 2010 by the possibility that Richina Pacific could be able to acquire the Asian assets of AIG, the international insurance company. I accept that they devoted their attention to this idea at the time. I also accept Mr Yan's evidence that had Richina Pacific so acquired the Asian assets of AIG, some of the problems associated with removing funds from China may have been lessened. Nevertheless, such distractions do not really explain why it took so long for Mr Walker and Mr Yan to respond to Dame Jenny's substantial concerns.

[81] After no further response was received, Dame Jenny emailed Mr Walker again on 27 February 2010 saying that she appreciated that some of the issues were very important "and do need our attention as I am personally not comfortable with things as they are". When she gave evidence, she explained why she raised these matters, including:

> 103 … I wanted to be very clear as to whose overall responsibility it was to support the New Zealand division of the wider Richina group so that the board could be confident that Mainzeal could meet the solvency test. Both Clive and I, as the independent directors of Mainzeal, wanted to be extremely clear about our obligations. Of course, we knew we had responsibility as directors of Mainzeal, but I wanted it recorded that, despite the restructure, the New Zealand division still had the benefit of the China assets.

[82] There again does not appear to have been any formal response to the further email. The minutes of the board meeting on 24 May 2010 record that Dame Jenny would follow up with Mr Walker again.

[83] The accounts for Mainzeal for the financial year ending 31 December 2009 also came to be addressed in May 2010. They recorded an operating profit of a modest $853,560 when the interest on the intercompany loans is excluded. As Dame Jenny frankly acknowledged, the intercompany receivables from RGREL and MLG "exceeded the total equity, so clearly underpinned Mainzeal's balance sheet solvency". She said in her evidence, however:

> 136 From our perspective, the receivables effectively sat with [Richina Pacific], backed by the China assets and companies. We knew that [Richina Pacific] had the ability to support Mainzeal, including by repaying those debts if required. We also had confidence that Mainzeal could perform in the market and we did not anticipate this call would be required. Beyond the receivables

> themselves, [Richina Pacific] was continuing to support Mainzeal through providing security for bonds to be issued and providing cash when required.
>
> 137 On that basis, the board agreed that Mainzeal could continue to meet its obligations for the next 12 months.

[84] Her email inquiries nevertheless still remained unanswered. Dame Jenny referred in her evidence to the next response to them, being from Mr Yan. This was not until 14 June 2010 by way of an email to the other Mainzeal directors, which included an observation that "Richina will maintain substantial NZD cash in NZ going forward but will maintain it separately from Mainzeal — which is needed are available to Mainzeal". That comment did not appear to respond to the concerns in a meaningful way, and involved a degree of ambiguity.

[85] The issue was otherwise left on this basis. There is no reference to the issue in the minutes for the board meeting on 19 July 2010. On 12 August 2010, the directors received email advice that "Richina has requested an additional NZ$1.2 million advance to be paid tomorrow". Dame Jenny again raised her concerns in response. In an email to Mr Yan and the other directors she stated:

> I am very concern[ed] by this request and would prefer not to approve the additional amount requested until the matters outlined below are resolved.
>
> The Mainzeal Board has asked on a number of occasions for the matter to be clarified as to the accountability and responsibility surrounding related party transfers of funds from Mainzeal to other entities in the Group. As you know, as Mainzeal Directors we are all responsible for the contracts we sign and our ongoing ability to meet our obligations to fund those contracts. As we have no formal arrangements in place to cover the guarantee of these requested transfers and despite the fact that we are recording these as part of our Mainzeal Board reports I know the Directors have real concerns around this issue. I have raised this with yourself and John Walker on a number of occasions and the matter is still not clear despite assurances that the issues would be dealt with.
>
> While I note your desire to run a central treasury function for the NZ interests it is unreasonable to ask Mainzeal Directors to approve the associated related party transfers without the clear understanding if we are liable for these decisions and the associated obligation or of other persons or Directors are legally responsible. We are not informed as to the purpose of these transfers and would not need to be so if we had a clear indication from those responsible for the group that the request had been approved. We have asked that you and EY or other advisors make the appropriate arrangements and accountabilities clear to safe guard us all. I believe it is essential that at our Board meeting on the 26th of this month this matter is clarified in writing from John Walker and

> yourself so that everyone can have confidence and be clear about our responsibilities.

[86] Mr Tilby added to this concern in an email of the same day. He raised the link between this issue "and of course Mainzeal security going forward". He said: "We appear to be at an overly flexible situation right now and I am somewhat uncomfortable as an independent director …".

[87] Mr Yan replied by email the same day. He said that a board paper was being prepared for the next board meeting. He also stated:

> Mainzeal has always operated and continue to operate under a shareholder/parent guaranty and all the cash are shareholders' cash. There is no issue of independent director liability as Mainzeal is a wholly owned subsidiary and NOT an independent company as such. Under the guaranty, the group has always been willing and so far able and will only be more able going forward to guaranty all its obligations.
>
> As I have repeatedly explained in the past Richina does have issues of taking money out of China but it did large amounts last year when Mainzeal needed them so now Mainzeal [has] the cash and we have found a solution for taking cash out through King Façade, we are simply dealing with a time issue.
>
> Again, there are no independence issues here as it is ultimately the shareholders who are on the hook for everything. Mainzeal is no in way compromised and Richina has always supported it to the full extent even during its more dire situations.

[88] Whilst Mr Yan's email was plainly intended to convey that there should be no concern, a number of aspects of it were misleading. The suggestion that Mainzeal was not an independent company is plainly incorrect. The directors remained responsible for Mainzeal as an independent company incorporated under the Companies Act. More importantly it was incorrect to say that there was a guarantee which meant that "the shareholders" were "on the hook for everything". Not only was this not true, but matters were structured in a way that meant that there was no such legal responsibility. The Mainzeal report to the Richina Pacific board for May 2009 recorded that following separation Mainzeal was to be independent, and that the only exception was the continued availability of bonding support. The guarantee mentioned in the first paragraph of the email, at least in written form, was now coming from Richina (NZ) LP, and not Richina Pacific itself. In any event, such letters of comfort were provided

for audit purposes and it is not suggested that they were legally binding.[7] Equally, it is wrong to say that there were no independence issues as a consequence. As a response to the serious issues of concern, Mr Yan's email was unsatisfactory.

[89] By email dated 26 August 2010, Mr Walker also responded. His email described the new wider group structure. It enclosed a proposed resolution of the Audit Committee of Richina Holdings Ltd, the general partner of Richina (NZ) LP, approving transactions between Mainzeal and the Richina Pacific entities during the course of a calendar year allowing the Richina Pacific entities to extract up to a total of USD 3 million. Mr Walker also indicated that Richina Pacific's accounts could continue to be used to assist Mainzeal in obtaining work. The penultimate paragraph of his email then stated:[8]

> **Reporting Expectations of Richina Holdings' Board**
>
> As a result of the corporate restructuring, reporting that the Mainzeal Board previously made to the [Richina Pacific] Board should now be directed to the Richina Holdings Board. Going forward, Wallace and I would like to receive the materials that are prepared for the Mainzeal Board meetings. At appropriate and convenient occasions, Wallace and I would like to have conversations with the two of you to learn first-hand your views regarding Mainzeal and its businesses and management. However, we believe that it is the role and responsibility of the Mainzeal Board to make going concern, solvency and similar determinations with respect to Mainzeal.

[90] This response, and the proposed resolution did not formalise any support to enable the directors of Mainzeal to be satisfied that the company remained solvent, and also it contemplated the group extracting more funds. That did not address the concerns raised by Dame Jenny and Mr Tilby, although it did confirm that it was the Mainzeal directors who were responsible for solvency and going concern determinations.

[91] The minutes of the Mainzeal board meeting on 26 August 2010 only recorded that Messrs Walker and Yan would work further on the paper recording the governance arrangements. Dame Jenny said in evidence, however, that from the perspective of Mainzeal's board "the important part was that the board knew what funds were going out so that it was clear what funds needed to be returned when required". It is true

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7 See [37] above.
8 The reference to Wallace is to Mr Mathai-Davis, another Richina Pacific director.

that the reality was that before that time there had not been a clear record of the funds flows in and out of Mainzeal under the control of Richina Pacific. But the more central issue concerning solvency, responsibility for the liabilities being incurred, and responsibility for support was not addressed.

Expressions of support

[92] It also appears that the Richina Pacific board considered the nature of its support again in October 2010. On 5 October 2010, a series of resolutions and letters relating to the issue of support were prepared by Richina Pacific staff. Ms May Kwan of Richina Pacific sent draft resolutions of support by email to Messrs Walker and Yan. They included letters of support from CHC to RGREL and RGREL to Mainzeal. In effect, they would have formalised an expression of support from CHC — the entity that actually held the substantial assets in China — to Mainzeal. This expression of support would have accordingly been significant, even though such letters are said not to create legally binding obligations.

[93] On 6 October 2010, Richina Pacific had a board meeting where these matters were discussed. In the agenda, under the heading "Projected Sources of Capital", was an entry for "Mainzeal cash position". It is accordingly apparent that Richina Pacific continued to view Mainzeal as a potential source of funds at this time. The minutes also record discussion of the issues raised by Dame Jenny and Mr Tilby. The Richina Pacific board approved the financial support documents and resolutions from RGREL, and the board agreed that Mr Walker would provide them to Dame Jenny. Although it does not appear expressly from the minutes, it is also clear that a decision was made not to provide such formal expressions of support from Richina Pacific or CHC, as had been contemplated by the drafts that had been prepared. I address the evidence of Messrs Yan and Walker on that issue below. The fact that it was decided not to express such support from these entities is significant.

[94] The next Mainzeal board meeting, on 13 October 2010, returned to the issue. It does not appear that any documents containing expressions of support had been sent for the purpose of this meeting. The minutes recording the discussion stated:

> ➢ **Governance (RY on teleconference)**
>
> - RY discussed his views on the governance issues and the fact that nothing has changed.
>
> …
>
> - Board agreed that the governance structure had to be formalised prior to Christmas in conjunction with Richina Global Real Estate. RP/RY/PG
> - RP to track down the original Mainzeal Board charter to review and update as necessary RP
> - Authority limits need to be circulated as a refresher.

[95] The note in the minutes recording Mr Yan's view that "nothing has changed" echoes the view expressed in his earlier email.

[96] Following that meeting, on 24 October 2010, Dame Jenny emailed Messrs Yan and Walker with the Mainzeal board papers, and advised as to matters that "need attention". The first was that the "Governance relationship needs to be addressed and finalised prior to Christmas (not reflected in the papers)". In response, Mr Walker said this was being worked on, and he attached the proposed resolutions of RGREL and Mainzeal. No proposed Richina Pacific or CHC letter or resolution was provided. Moreover, the Mainzeal resolution stated:

> That pursuant to the delisting of Richina Pacific Limited ("RPL") the concept of independent directorship has become irrelevant in the context of [Richina Pacific] and the Company.

[97] But the question of independent directorship was relevant. As mentioned previously, the directors were still responsible. So this resolution effectively misrepresented the legal position as to the directors' responsibilities. In addition, whilst the expressions of support were apparently not legally binding, and so have limited ultimate value in a legal sense, it is significant that no such resolutions or letters were being offered from either Richina Pacific or CHC.

[98] In their evidence before me, Mr Walker (and with less certainty, Mr Yan) said that all the resolutions with the supporting letters that had been prepared, including from CHC to RGREL, were passed and signed. Dame Jenny also gave evidence that this was her recollection, and they were very important documents for Mainzeal's directors. I do not accept that these documents were signed, or that the resolutions

were passed. Such executed documents have not been produced. There is no record of them being passed or signed. Later emails make no reference to their existence. It does not appear that the draft documents were even sent to Mainzeal. The letters of support relied upon by the auditors for going concern purposes after this point came from Richina (NZ) LP. The evidence is clear that no such resolution or letter was ever actually passed or given by CHC.

[99] I also accept that there must have been a decision to limit the written expressions of support so that they only came from RGREL. This cannot be the consequence of an oversight. Drafts had been prepared, but they were not executed or provided. Notwithstanding the evidence of Messrs Yan and Walker, I accept the plaintiffs' argument that a conscious decision was made by Richina Pacific against CHC providing such a written commitment.

[100] Dame Jenny suggested she had a degree of satisfaction at this stage, however. She said in evidence that she "believed, based on John's and Richard's undertakings, that RGREL also had the ability to look to the rest of the group for support as needed". This can only be as a result of verbal assurances, or inferences taken from what had been said.

Mr Pearce's concerns

[101] During this period, Richina Pacific continued to access funds from Mainzeal's accounts. It appears that by this stage Mr Pearce, the Chief Financial Officer of Mainzeal, had become very concerned with how things had developed following the restructuring in this respect. By email following the board meeting on 13 October 2010, Mr Pearce provided a confidential update on the meeting to Mr Walker. Mr Pearce raised a number of concerns, including with Mr Yan's comment that "nothing has changed". Mr Pearce said:

> The main point that continues to require agreements is what exactly are the directors obligations and duties under the new structure that you have previously addressed in an email.
>
> …
>
> As you know governance is all about transparency and my fear (as with the Waiheke winery potential purchase) is that if this is not adequately sorted out

> and agreed then Jenny and Clive may ultimately resign which Peter and I certainly don't want to happen.

[102] The reference to the Waiheke winery related to Mr Yan's project to acquire vineyard interests on Waiheke Island so that it could be developed as a hotel for Chinese Communist Party officials, with cash used from Mainzeal's accounts to assist the purchase. Mr Pearce went on to say in his email that his concern was to demonstrate to the market that Mainzeal was well governed, and the objective was to protect everyone's interests (including Mr Yan's). He also noted that it would be interesting whether Ernst & Young would regard the related party balances as impaired, and he reported that Mr Yan wanted to solely handle this issue with Ernst & Young during the audit and did not want others involved.

[103] When he did not receive a substantive response from Mr Walker, he followed up by email dated 12 November 2010. He said that he remained "deeply concerned about the activities that are happening down here", and that in connection with cash flows "as CFO this is alarm bell material for me" and that "I know this is blunt but I find the whole thing nothing short of frightening".

[104] Mr Walker responded on 13 November 2010. He said that it was "important for the Mainzeal Board to have a full and frank discussion with Richard regarding the concerns from Mainzeal's perspective, including from the perspective of Directors' obligations". He said that Mr Pearce's discussion paper, called the "White Paper", could be very helpful in moving this issue forward. Mr Pearce had also located the original Charter and accompanying letter. Mr Walker reported that he had discussed the position with Mr Yan, who had agreed that the issue needed to be taken seriously.

[105] No such full and frank discussion appears to have occurred. The minutes of the board meeting on 19 November 2010 simply record:

> **5. GOVERNANCE**
>
> - PG to obtain external advice from EY. PG
> - Need to establish framework on how to go forward in 2011.
> - JS requires an understanding of principles.

[106] The only real progress that seems to have been made is that a request for external advice from Ernst & Young was sought on the issues.

Early 2011: Ernst & Young report

[107] In January 2011, Ernst & Young provided a draft corporate governance report following this request for advice. It was provided from different personnel at Ernst & Young from those responsible for the audit. The report made a number of pertinent findings and recommendations. It pointed out that the loans to MLG were not verified in terms of their collectability. It recorded that this had been identified in the audited accounts as an issue in relation to Mainzeal continuing as a going concern. It stated in the summary:

> MPC has, in recent times, entered in to related party transactions with a non-group sister company, MLG. These transactions have in essence been cash transfers. As MLG is outside the immediate group of companies to which MPC is a member, and as it is not audited, uncertainties exist from an audit perspective as to the ultimate collectability of the related party balances. The challenge for MPC as regards the related party receivable balances is how to present these in the financial statements in such a way as to allay the concerns of customers or commercial partners.

[108] The report also stated that "the issue is that the resultant receivable held by MPC is NOT collectable when demanded". It also recorded that Messrs Gomm and Pearce had advised that "Parent company relies on sister company in China. Conditional on getting funds out of China". It further stated that the board had "no formal risk management framework" or audit committee, and that the fact that the independent directors were not also directors of the Richina Pacific entities "may raise the perception that the independent directors of MPC are unable to exercise any effective influence [on] the operations of MPC, its structure or its balance sheet due to the influence of its shareholder." This report accordingly strongly reiterated the issues of concern.

[109] The plaintiffs identified January 2011 as one of the two points in time when they allege the directors breached their duties under ss 135 and 136 — that is, allowing Mainzeal to trade in the manner it was beyond that date was in contravention of ss 135 and 136. The alternative date identified by the plaintiffs was July 2011. The clear

identification of the issues by Ernst & Young at this time is accordingly of significance to the plaintiffs' case.

[110] Ernst & Young further considered Mainzeal's position as auditors during this period. By letter dated 28 April 2011, it signed off the audited accounts for Mainzeal for the financial year ending 31 December 2010. The accounts had been signed off for the directors by Dame Jenny and Mr Yan on the same day. Those accounts recorded an operating loss of $1,020,553, but a profit before tax of $1,758,186, attributable to the accruing interest on the intercompany loans of $2,778,739. Excluding that interest, which was essentially notional only, the company made a loss. The intercompany receivables included liabilities by MLG of approximately $30 million, and the RGREL liability of approximately $12 million. The accounts prepared by the company recorded in Note 14:

> **14. Continued shareholder support**
>
> The considered view of the Directors of Mainzeal Property and Construction Limited is that, after making due enquiry there is a reasonable expectation that the Company has adequate resources to continue operations at existing levels for the next 12 months from the date of the audit report. The shareholders of Richina Global Real Estate Ltd, the immediate parent of the Company, have undertaken to provide financial assistance to the Company, if necessary, to ensure that the Company will meet its debts as they fall due.

[111] The audit letter stated with respect to this:

> **Emphasis of Matter**
>
> We draw attention to Note 14 of the financial statements which describes the continued support of the shareholders of Richina Global Real Estate Limited, the immediate parent company. The financial statements have been prepared on the going concern basis, the validity of which depends upon the continued financial support by the shareholders of the immediate parent company. The financial statements do not include any adjustments that would result should the support of the shareholders of the immediate parent company be discontinued. Our opinion is not qualified in respect of this matter.

[112] The support of "the shareholders of the immediate parent company" was central to this conclusion. The relevant letter was dated 28 April 2011, and was provided on behalf of Richina (NZ) LP. It stated:

> Dear Directors,
>
> In order for the directors of Mainzeal Property and Construction Limited ("MZL"), to be in a position to support the use of the going concern basis in preparing the financial statements of MZL, which means that MZL are able to meet its debts as and when it becomes due in the normal course of business, continue in operation without any intention or necessity to liquidate or otherwise wind up its operations, and the value of the company's assets is greater than the value of its liabilities, including contingent liabilities, and
>
> > to give assurance to the directors and officers of MZL of the firm intention of Richina (N.Z.) LP to financially support MZL in the future,
>
> we hereby acknowledge to the directors of MZL that:
>
> > Richina (N.Z.) LP accepts responsibility of providing and undertakes to provide sufficient financial assistance to MZL as and when it is needed to enable MZL to continue its operations and fulfil all of its financial obligations now and in the future.
>
> This undertaking is provided for a minimum period of twelve months from 28 April 2011.

[113] A letter in essentially identical terms was provided to RGREL. These letters remained in essentially the same form as they had appeared throughout. Notwithstanding the earlier drafts that had been prepared in October 2010, there was no such letter from CHC.

Project Citron: The Pre-Paid Goods Agreement

[114] Attempts were nevertheless made to develop a plan to deal with Mainzeal's balance sheet solvency issue and the Ernst & Young advice during the year. On 24 August 2011, Ernst & Young provided a "Project Citron" report in which a plan was proposed. That plan reported that the approximately $25 million of equity in Mainzeal's balance sheet at 31 December 2010 included $42.4 million in related party receivables, which it said was the "result of historical extraction of funds from MPC for utilisation within the broader Richina Group". The report recorded that MLG did not have sufficient funds to repay the intercompany balance were it to be called. Those loans were repayable under the terms of the loan agreements at around this time but they were not repaid. Neither were they demanded. What the report addressed as a "recapitalisation plan" was an arrangement whereby a Richina Pacific entity would purchase building materials in China, and then supply them to Mainzeal and reduce

the MLG debt to Mainzeal as payment. In other words, the debt would be reduced by the supply of goods from China in the form of building materials.

[115] The proposals addressed in the Project Citron report ultimately reached fruition on 31 December 2011, when a series of transactions were entered into. The arrangement came to be known as the Pre-Paid Goods Agreement. In summary, MLG's loan to Mainzeal in the amount of $33,139,247.70 was restructured so that it was no longer accruing interest, and was now repayable within 10 years, subject to MLG's profitability. CHC was assigned the right to receive the repayments, and in exchange CHC would supply product to Mainzeal in the form of construction and building material under a forward purchase agreement. A schedule prepared at the time contemplated an effective elimination of the debt by such supply of materials over a three-year period ending in 2014.

[116] There were two advantages of this arrangement. First, it was a mechanism that apparently addressed the foreign exchange restrictions existing in China — an obligation to pay money to Mainzeal was replaced by the supply of goods. Second, it was consistent with the plans that Mainzeal had to take greater advantage of the supply of Chinese building materials, particularly in relation to building facades (the exterior cladding of buildings). Mainzeal had a general plan to move to supply of particular building products in this area, through a related company known as King Façade, and had already been receiving goods by such a mechanism. It had used such facades on a development for Baradene College in Auckland.

[117] The arrangement had considerable disadvantages, however. Whilst this was a technique to begin to deal with the balance sheet issue, the issue would still remain until the debt was fully forgiven. No interest was earned in the meantime. It also tied Mainzeal to a single supplier of such building materials. Ernst & Young also referred in its advice to the risks inherent in a Chinese supply chain. These risks came to fruition as the supply of building materials from King Façade became a very significant problem, causing significant losses to Mainzeal.

[118] I accept the plaintiffs' argument that the Pre-Paid Goods Arrangement was of considerably less value than the repayment of the loans. It was a compromised

solution. Accepting it in place of repayment raises a real question as to whether Richina Pacific was able to provide the financial support Mainzeal required, given the Chinese foreign exchange limitations, and also whether it was fully willing to do so. Moreover, it transpired that the agreement was not effective — the Chinese law experts called by the plaintiffs and the defendants agreed that it was not consistent with the laws of China, and it was therefore not enforceable. On the subsequent liquidation of Mainzeal it could not be enforced even in relation to the outstanding balance owing by CHC to Mainzeal. It accordingly had no value to the liquidators.

[119] The Mainzeal directors nevertheless agreed to the entry of the arrangements. The only external advice they took on this proposal came from Ernst & Young. The directors received no independent legal advice from either New Zealand or Chinese lawyers, but relied on the input of the Richina Pacific advisors in considering and entering the arrangement.

2012: Cash flow difficulties emerge

[120] During 2012, Mainzeal began experiencing cash flow difficulties. These difficulties primarily arose in conjunction with a significant construction contract that Mainzeal had entered with Siemens. Siemens had the contract for the upgrade of the electricity network link between the North and South Islands owned and operated by Transpower. Transpower was upgrading the link to introduce what is known as Pole 3. That included construction work at each end of the link at Benmore in the South Island and Haywards in the North Island. Mainzeal won the contract with Siemens to do the construction work at each of those locations. This was a different kind of construction works, involving infrastructure, and the contract was also different from that usually used.

[121] Disputes were beginning to emerge between Siemens and Mainzeal. On 26 April 2012, Mr Pearce advised directors that Mainzeal should meet its cash flow projections through to 20 May 2012, but he indicated that there could be a shortfall of $9 million if Siemens refused to make an interim payment. At the board meeting on 23 May 2012, the board recorded there was a $7–7.5 million gap arising from Siemens, and that Mainzeal's bank, BNZ, was not prepared to extend Mainzeal's facilities after

it was informed. Richina Pacific agreed to fund this cash flow gap. It did so by using Standby Letters of Credit (SBLCs). This was a new way in which funds could effectively be extracted from China, which had been authorised by the Chinese authorities. In simple form, Chinese banks could make facilities available that allowed offshore banks to give credit that could be used offshore through SBLCs. The extent of the Chinese banks' ability to provide such loan facilities depended on overall limitations placed by SAFE on what the Chinese banks could make available.

[122] Sir Paul Collins joined the Mainzeal board in April 2012. He effectively represented the next largest shareholder interest in Richina Pacific after Mr Yan and the North American shareholders, through the investment vehicle Active Equities, although this interest was much smaller at approximately 4.5 per cent. He explained that he had been interested in the group because of its Chinese investments, and that he was not keen on owning a construction company in New Zealand. However, he was prepared to join the Mainzeal board to help the group. It appears that there was a plan for him to succeed Dame Jenny as Chairperson. Almost immediately after joining, he identified the significant underlying issues. When signing the forms in which he consented to act, which he sent to Mr Yan on 10 April 2012, he identified that without Chinese support "Mainzeal would not have survived" and that a significant cash injection was desirable. Later that month, he suggested that $20 million should be introduced as preference share capital or subordinated debt.

[123] At the 23 May 2012 board meeting, there was also discussion of a further restructuring, which Mr Yan would discuss with Ernst & Young. This is the beginning of what was then called "Project Shutter". The general idea was to build up New Zealand entities outside of Mainzeal with assets to provide a stronger capital base within New Zealand. There were two related advantages of this approach. First, it meant that Mainzeal would be less of a target for leaky building claims, because its assets would be shifted into these new entities.[9] Second, the entities outside of Mainzeal would be more attractive to third parties, including the bondsman and the Chinese banks, because they would not be vulnerable to the leaky building claims.

[9] I note that this strategy would protect the assets from other creditors as well. It is consistent with the general desire not to place such assets at risk due to Mainzeal's trading operation by structuring them beyond legally enforceable reach.

[124] By this stage the leaky buildings problem had become a major one as a result of several claims being pursued against Mainzeal. They were referred to by Mainzeal as "legacy" claims. A trial for one of the leaky building claims, Bay Point, was set down for 2 July 2012. A further leaky building claim, Botany Town Centre, was also well advanced by this time. In addition, the King Façade operation was also problematic, with the board notes recording that one of the projects called "Geyser", which had used King Façade material, was a "huge challenge" at this time.

[125] At the further board meeting on 26 June 2012, Mr Pearce advised that cash flow remained critical as a consequence of the Siemens dispute. Serious further delays with the Geyser project were continuing as a result of difficulties with delivery from King Façade. The impact on the cash flow arising from that issue alone was described in Mr Gomm's report as "serious when coupled with the slow progress being made with Siemens". The "legacy" issues were also of growing concern. Mr Yan presented a revised version of the restructure proposal at the meeting — now called Project New Blue rather than Project Shutter. It was summarised by Dame Jenny as "putting Mainzeal's good assets into a new company and isolating legacy claims in the 'old' Mainzeal, while at the same time creating a holding company for all Richina's Mainzeal companies, to be called Mainzeal Group Ltd". The board agreed to further consider the restructuring.

[126] At a board meeting on 5 July 2012, the increased cash flow problem was addressed. Just prior to that meeting, Sir Paul commented in an email that it was a "precarious position to say the least". BNZ had put a revised proposal to Mainzeal, but this required a personal guarantee from Mr Yan, supported by a second mortgage over his Remuera property. In terms of the personal guarantee, Sir Paul advised Mr Yan by email that, given BNZ's security over other assets, Mr Yan was not truly at risk. Sir Paul said in the email that BNZ "would always get their money out — it's all the unsecured creditors who are seriously exposed". This comment reflected the true position the unsecured creditors were in. Further funding was necessary for survival. The BNZ facility was to increase to $12 million, made up of $8 million core facility and $4 million excess. The facility was to be reviewed monthly, and the bank required daily cash flows. The board noted that Richina Pacific would make a further $1 million available, with a further $5 million the following week, and $2.7 million the

week after. This involved a total suggested support from Richina Pacific of $8.7 million. The board resolved to accept the funding from both BNZ and Richina Pacific.

[127] Mr Yan explained in evidence that he personally had no real concerns about Mainzeal's solvency at this time, and that he did not regard providing a personal guarantee as of concern. The inherent problems were, however, becoming increasingly apparent, including to Sir Paul. In an email to Mr Yan of 10 July 2012, Sir Paul stated:

> I would have to say I'm at my wits end. I joined the board under the impression Mainzeal was solvent - I accept Siemens came from left field but equally I accepted all your representations re support and more recently redomiciling in NZ later this year and taking out the BNZ. As you will well appreciate I have dealt with a lot of bad news stories over the years and have found that matters can be worked through when you have all the cards on the table. I don't have that confidence here. …

[128] In his evidence Sir Paul suggested that this email had been written with a degree of emphasis because he was seeking to make a point. He said that he believed that Mainzeal was solvent in April 2012 when he joined the board, and that, whilst Mainzeal was always relying on the group's balance sheet and its significant Chinese assets for solvency, he believed the group "could financially support Mainzeal when necessary". He sought to explain his email exchanges over the period as being influenced by the particular circumstances, and the emphasis he was trying to give. Nevertheless, his emails throughout 2012 demonstrate a growing concern regarding Mainzeal's reliance on expressions of support.

[129] The dispute with Siemens continued to cause considerable concern in the next few months. It came to be addressed by adjudications under the Construction Contracts Act 2002. That Act set up a dispute resolution system that was principally directed to resolving cash flow disputes in the construction industry, and to prevent a perceived problem of company failures caused in that industry by disputes and the withholding of cash flow. Such adjudications were designed to be prompt, and not to finally determine issues in dispute, but to determine who held the cash in the meantime.[10]

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10 A useful description of this background is set out in the decision of the Court of Appeal in *Laywood v Holmes Construction Wellington Ltd* [2009] NZCA 35, [2009] 2 NZLR 243 at [11]–[15].

[130] A series of adjudications under the Act were held to resolve the issues under the Siemens contract. In September 2012, Mainzeal lost the first adjudication involving an amount of $13.6 million. That was a major blow. By this stage the restrictions on moving funds out of China also became more evident. In an email to Sir Paul on 13 September 2012, Mr Yan stated:

> We can fund the KF exports in China but we can't find any bank willing to lend to any NZ entity foreign cash even against our cash deposits in China because of the extremely poor financial results and the huge misses of budgets/forecasts for the past two years in a [row] by a wide margin. There is no other magic solution unfortunately! Our China businesses are already drained of all their cash possible for offshore use and our licenses are now at stake.

[131] A second adjudication claim for $23 million (which included the first $13 million) was due in October 2012 before a different adjudicator. In October 2012, Mainzeal lost the second adjudication. At this stage, Mr Yan said that for the first time he became seriously concerned about non-payment by Siemens.

[132] The analysis being undertaken by Sir Paul at this time reflected the difficulties. In an email on 8 November 2012, to Messrs Walker and Yan, copied to Dame Jenny, Sir Paul identified some of the key issues, including that given the board's dependence on China "an important aspect is an MOU detailing key points eg I/C company balances, prepaid materials etc". The reference to an MOU records that Sir Paul had identified the need for the relationship with Richina Pacific to be recorded in such a document, as well as the need for capital.

[133] A strategy was then advanced by the board that included elements of the Project Shutter/New Blue concept. Mainzeal also began selling some of its assets to deal with the cash flow issue, and also to establish the separate entity with financial strength, as had been contemplated by the Project Shutter proposal. Two significant properties were identified for sale — a property at Carbine Road, thought to be worth approximately $5 million, and the sale of Mainzeal House, thought to be worth approximately $15 million. The new entity to be created was Mainzeal Group Ltd. Mainzeal Living, which had been a successful division of Mainzeal, would become a wholly-owned subsidiary of Mainzeal Group Ltd, along with other entities.

Legal advice obtained

[134] On 1 December 2012, Sir Paul emailed the directors to say that specialist advice on solvency was urgently required. He also expressed the view that, if Mainzeal did not have BNZ support, the company was insolvent and a receiver should be appointed. He also said that Mainzeal needed additional equity of not less than $10 million. By this stage, Mr Pearce had emailed the board to say that he was getting complaints daily about bills not being paid by Mainzeal.

[135] In the following days, the directors duly obtained independent legal advice from Chapman Tripp's Auckland office. This was provided by email. This was considered and discussed at the board meeting on 4 December 2012, which Mr Michael Arthur of Chapman Tripp attended. The following is recorded in the board minutes:

> **4. INDEPENDENT LEGAL ADVICE**
>
> - Michael Arthur (MA) addressed the meeting in his role as independent legal advisor to the Board. His advice to Directors was to attend to the responsibilities laid out in his email of 3 December (4 items listed below):
>
>   1. Obtain, and critically consider, good and reliable information and advice.
>
>   2. Monitor closely, and with increased frequency, performance of the company against cash-flow projections. Essentially, the same question (whether on-going trading is prudent) should be asked repeatedly, as all new information becomes available.
>
>   3. Ensure that any third party commitments, on which the Board is relying, are documented in a legally binding way.
>
>   4. Consider very carefully any significant new obligation. Specifically, does the Board reasonably consider that the obligation will be met when it falls due?
>
> - In addition to the above, MA provided further clarification with respect to solvency considerations and any plans to trade out established for Directors.
>
> - These are summarised as follows:
>
>   - The Courts are sympathetic to Directors' rights to trade out of difficult business situations; that they should be given reasonable time to do so (months generally, not days or years). Normally trading out required committing more equity to the company.

- In deciding to trade further, Directors had to consider the risk of injury to the "body" of creditors but do not need to base key decisions on the needs of individual creditors.

- Ask always, "Do I/we have the information that I need, do I trust it?"

- Have more regular meetings and ask the right questions.

- If other members in the group are being required to support, the interests of those Boards need to be considered and their approval obtained.

  (Note: this seems not to be an issue in our situation).

- With regard to email item 3 above, all commitments from the shareholder or others need to be legally structured and specific to each pledge made. Frank Chan (FC) will draft the necessary commitments for Board approval.

- MA stressed how important it was to get PWC validation of any plan going forward.

[136] This appears to be the only external and independent legal advice ever obtained by the directors in relation to their duties, although they had the earlier advice from Ernst & Young. This legal advice raises a number of important issues concerning the directors' responsibilities at that time, including the advice that the board should ensure that any third-party commitments on which it relied be documented in a legally binding way.

[137] On 8 December 2012, Sir Paul emailed Dame Jenny and Mr Yan and emphasised the need for a binding commitment of support. He described it in the following way:

- Solvency/Capital - while "cash is king" clearly solvency is also important - the suggested underwrite/indemnity/confirmation of support from the parent if appropriately worded and given the equity position in China will be adequate in my view. It should come from Richina Pacific Limited and Richina Holdings (BVI) Limited and be signed by John and Richard.

[138] At the board meeting on 11 December 2012, the board was updated on the asset sale programme. Discussion was had over an overall settlement with Siemens, which had been required by BNZ, but which the directors regarded as "inequitable". The ultimate settlement involved Siemens paying final amounts so that the total paid to Mainzeal was $86.5 million. Mr Walker described this in evidence as Mainzeal

settling with a gun to its head. He estimated that Mainzeal lost between $4 and $16 million on the settlement. But, notwithstanding this pressure, the project still involved Mainzeal making a profit on the Siemens contract overall which Mr Tilby confirmed was approximately $4.5 million. And the settlement eased the immediate cash flow pressure the Siemens dispute had generated.

The collapse

[139] Notwithstanding that the Siemens issue was resolved, the company was still under extreme financial pressure. At the 11 December meeting, Mr Yan said that he was committed to pursuing repatriation of more capital through China at dates in March and June 2013, but that the regulatory framework in China did not allow earlier repatriation. Mr Yan confirmed that there was no capacity to bring further cash equity from China before 20 December 2012. Mr Tilby's notes of the meeting record that Dame Jenny asked Mr Yan to "put this commitment in writing to the Board".

[140] Mr Yan explained that, by Christmas 2012, he realised that Mainzeal may collapse. This raised an issue with his personal guarantee. He approached both Dame Jenny and Mr Gomm in January 2013 and asked them to talk to the BNZ and request that his wife be released from her personal guarantee. Dame Jenny gave evidence that Mr Yan told her that he could not continue to support Mainzeal unless the guarantee affecting his wife was waived. She said that she then told Mr Walker of the conversation, stating that unless Mr Yan resolved the cash equity issue there was "a real risk that I, and the other directors, would resign as we felt that undertakings previously given may not be able to be relied on".

[141] By email dated 22 January 2013 to Mr Yan, Mr Walker and the directors, Dame Jenny sought confirmation in writing that undertakings in relation to materials from China would continue, that the equity injections would be provided and that "[i]f this is not the case, please notify us immediately so we may consider our position, our obligations and the associated implications for the company". She attached an extract of a commentary on the legal obligations for directors arising from s 135 of the Companies Act. By email dated 23 January 2013, Mr Yan confirmed the commitments

he had made in early December, but he identified that he needed to work out how this could be achieved.

[142] In their evidence, Messrs Yan and Walker said discussions then took place with the new Chairperson of CHC, Mr Huo. Mr Huo was previously the Chief Executive Officer of SLC, but he was now the Chairperson of CHC in place of Mr Yan. Mr Huo did not give evidence. Mr Yan said that Mr Huo had advised that CHC could not give assurances on funding Mainzeal until it demonstrated profitability. In any event, it appears clear that Mr Yan was under significant personal pressure, and that he was very concerned about the personal guarantees, and the impact on his family, including his children.

[143] On 29 January 2013, Mr Yan wrote a letter to the directors seeking an urgent Mainzeal board meeting. In it he suggested that Mainzeal was no longer a going concern, and he further suggested that a resolution be passed to invite BNZ to appoint receivers.

[144] All of the directors gave evidence of their surprise at this turn of events, and the collapse of Mainzeal that followed. Mr Walker explained that he had been involved in very significant matters as a commercial lawyer in the United States, but that this period was the most stressful of his life. He said that he believed that Mr Yan was too pessimistic. He said that he resumed negotiations with Mr Huo and, after making greater progress, believed he could get further commitments from CHC. Mr Yan then further wrote to Dame Jenny to indicate that as long as Mainzeal could pay for building materials from China the conclusions he had drawn in his earlier letter would no longer apply.

[145] In the meantime, however, Mr Yan's earlier email had been communicated to BNZ. By letter dated 31 January 2013, it advised that it was suspending any further advances on its facilities. This triggered Mainzeal's ultimate demise. The independent directors all resigned on 5 February 2013. Receivers were appointed on 6 February 2013. Mainzeal was placed into liquidation on 28 February 2013.

[146] Mr Yan described his views on the collapse of Mainzeal in the following way:

> 152. Essentially, Mainzeal just lost too much cash too quickly from August to October 2012 and as the shareholder, Richina just couldn't keep up with the volume and frequency of support that suddenly became necessary. This was not a lack of willingness to support Mainzeal, it was simply a matter of timing.
>
> 153. Again, there was never the question that Richina China would or could breach Chinese SAFE regulations so it was all about management of timing of cash movements between China and New Zealand. To achieve that, we needed time and we couldn't simply wave a magic wand to make it happen.
>
> 154. While over the years we managed many crises at Mainzeal, the Siemens hole was simply too big and caught me too suddenly. When our second Siemens CCA failed in October and the timing for the third CCA looked to run into the holiday period, and also the leaky building settlements were all worse than we had expected, that's when the BNZ panicked and these events ultimately led to the receivership.
>
> 155. I believe that the process of sending building materials (even without formal SAFE approval for the Prepaid in 2012) would have worked with time, except for the cash demands from the BNZ following the cash drain from Siemens.
>
> 156. The SBLCs were timed instruments to bridge the period of investment and return from those investments and when it became apparent that (despite management's projections) Mainzeal would suffer a much bigger cash loss than anyone ever contemplated at the beginning of 2012, Richina simply lost the ability to continue to support New Zealand from China in the timeframe required without breaching SAFE regulations (although as discussed below we did come up with a plan to sell some assets owned in China, but this would ultimately come too late).

[147] The collapse of Mainzeal had an immediate impact on Richina Pacific itself. That was because of the construction bonds that it had guaranteed. Mr Walker described the steps that were taken to deal with that situation. The problem was that, whilst Richina Pacific had considerable assets in China, it did not have much liquidity, including because of the stringent foreign exchange limitations. For that reason, it was not able to immediately meet the obligations arising under the bonds. In order to manage that situation, and also in order to minimise the extent of its obligations, Richina Pacific was put into voluntary provisional liquidation in Bermuda in March 2013. Negotiations then took place with the bondsman in relation to its obligations. Ultimately, it reached a settlement involving a payment of $19 million over a period of time. Richina Pacific then came out of provisional liquidation in December 2013.

[148] A series of emails sent by Dame Jenny after receivers were appointed are relevant. On 10 February 2013, she emailed the former directors, Mr Walker, and others, indicating that she was concerned about the position of creditors and that the

interparty receivables "which are on the Mainzeal balance sheet and which have been discussed many times between Richard and the Mainzeal Board and are assets which are owing to Mainzeal Property and Construction". On 14 May 2013, she emailed Messrs Walker and Yan, prior to meetings with Richina Pacific shareholders, saying that she hoped they would be making it clear that "the undertakings that Richina has given on many occasions in audit letter signings to EY and other Directors that the receivables outstanding to [Mainzeal] and in particular the money owned to staff and sub-contractors will be honoured". On 11 June 2013, she emailed Mr Walker saying that as far as she was concerned the receivables on Mainzeal's balance sheet remained an obligation.

[149] These receivables were not, however, from entities that had the assets to meet the obligations. Moreover, the undertakings being referred to by Dame Jenny had not been provided in clear or enforceable form. Unsurprisingly, therefore, Richina Pacific did not volunteer to make such payments.

SECTION 135 COMPANIES ACT 1993

[150] Against the facts as found above, I come to address the plaintiffs' claims for breach of the Companies Act. Section 135 provides:

> **135 Reckless trading**
>
> A director of a company must not—
>
> (a) agree to the business of the company being carried on in a manner likely to create a substantial risk of serious loss to the company's creditors; or
>
> (b) cause or allow the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors.

[151] It is important to be clear about the requirements for establishing a breach of directors' duties under this section. Guidance is available from the authorities, including the decisions of the Court of Appeal in *Mason v Lewis*[11] and *Löwer v*

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11 *Mason v Lewis* [2006] 3 NZLR 225 (CA).

Traveller.[12] There are also a series of relevant High Court decisions including *Re South Pacific Shipping Ltd (in liq)*[13] and *Fatupaito v Bates*.[14]

[152] In order to understand and apply s 135 it seems to me to be most important to apply the key requirements of statutory interpretation. One must begin with the text of the enactment, which must be interpreted in light of its purpose.[15] This includes an assessment of the context in which the statute operates. Reference to legislative history, and relevant reports, can assist in identifying the purpose and context of the provisions. The Court's ultimate function is to make the statute work as Parliament must have intended.[16]

The authorities

[153] The Law Commission's report on Company Law Reform and Restatement was published in June 1989.[17] In reporting to the then Government, the Deputy President of the Law Commission, Sir Kenneth Keith, advised that it was "important for the underpinning legislation to be clearly based on enduring policy".[18] The legislation subsequently enacted involved changes from the draft legislation proposed by the Law Commission in important respects. But the Commission's report can still be referred to for some of the enduring policy that was retained.

[154] The Commission included consideration of the provisions that became ss 135 and 136. Prior to the Commission's work, the Court of Appeal had released its decision in *Nicholson v Permakraft (NZ) Ltd*, in relation to the provisions in the Companies Act 1955.[19] That decision had suggested that there may come a point where the directors of a company would be required to address the interests of creditors when dealing with a company in a state of near insolvency. The decision

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12 *Löwer v Traveller* [2005] 3 NZLR 479 (CA).

13 *Re South Pacific Shipping Ltd (in liq)* (2004) 9 NZCLC 263,570 (HC), approved on appeal in *Löwer v Traveller*, above n 12.

14 *Fatupaito v Bates* [2001] 3 NZLR 386 (HC).

15 Interpretation Act 1999, s 5(1); and *Commerce Commission v Fonterra Co-operative Group Ltd* [2007] NZSC 36, [2007] 3 NZLR 767.

16 *Northern Milk Ltd v Northland Milk Vendors Ass Inc* [1988] 1 NZLR 537 (CA). See Douglas White "A Personal Perspective on Legislation: *Northern Milk* Revisited – Soured or Still Fresh?" (2016) 47 VUWLR 699.

17 Law Commission *Company Law: Reform and Restatement* (NZLC R9, 1989).

18 At viii.

19 *Nicholson v Permakraft (NZ) Ltd* [1985] 1 NZLR 242 (CA).

was regarded as controversial at the time, at least in some quarters. But provided it was understood that the relevant duties of directors were only owed to the company, and not directly to the creditors, the criticism was unfounded. It is now regarded as orthodox. The Commission referred to the decision, indicating that its proposals were consistent with it on that understanding.

[155] The Commission's proposed provision (s 105) was in different terms from that ultimately enacted. Its provision was described by the Commission in the following terms:[20]

> - directors are liable if they take unreasonable risk with the solvency of the company or where they trade knowing the company to be insolvent (section 105).
>
> > This provision restricts the scope of the existing section 320, which is considered to go too far in undermining the position of the company as a vehicle for the taking of business risk.

[156] As so described, the directors would become liable not only when they took an unreasonable risk, but also when they traded knowing that the company was insolvent. As enacted, s 135 does not create liability simply because directors trade on with a company knowing that it is insolvent. But the Commission's work recognised the significance of insolvency to the question of directors' duties. I elaborate on this below as it has significance for the present case.

[157] Even as enacted, the section attracted criticism. This included comment that it came close to a virtual warranty of solvency by directors, and a test more closely resembling that for negligence rather than recklessness. In *Mason v Lewis*, the Court of Appeal referred to this criticism in the following terms:

> [47] The courts have been alive to these concerns. First, in *Nippon Express (NZ) Limited v Woodward* (1998) 8 NZCLC 261, 765 (HC), Anderson J held that the duty under s 189 of the Companies Act 1955 (the equivalent to the present s 135) was not breached by directors until disclosure of a large debt made it clear that the company was hopelessly insolvent. In respect of the period before this disclosure, Anderson J noted:
>
> > Of course if a company operates at a loss for an extended period and has few, if any, realisable assets, there must be some risk to creditors.

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20 *Company Law: Reform and Restatement*, above n 17, at 52.

> Section 189 is concerned, however, with not mere risk but *substantial risk of serious loss* (at 261, 773). (Italics added.)
>
> [48] As to what is meant by "substantial risk" and "serious loss" Ross, *Corporate Reconstructions: Strategies for Directors* (1999) suggests:
>
> > The first phrase, "substantial risk" requires a sober assessment by directors as to the company's likely future income stream. Given current economic conditions, are there reasonable assumptions underpinning the director's forecast of future trading revenue? If future liquidity is dependent upon one large construction contract or a large forward order for the supply of goods or services, how reasonable are the director's assumptions regarding the likelihood of the company winning the contract? Even if the company wins the contract, how reasonable are the prospects of performing the contract at a profit? (at 40)
>
> [49] Secondly, both the High Court and this Court have drawn a distinction between the taking of legitimate and illegitimate risks. See *Re South Pacific Shipping Ltd (In Liquidation)* (2004) 9 NZCLC 263,570 (HC). This was a case under s 320 of the former Companies Act. That approach was confirmed on appeal in this Court in *Löwer v Traveller* [2005] 3 NZLR 479. Leave has been given to appeal to the Supreme Court in that proceeding (see [2005] NZSC 79). The distinction between legitimate and illegitimate business risks was also utilised by Ellen France J in *Walker v Allan* HC NEL CP13/00 18 March 2004, in respect of an action under s 135 of the current Act.
>
> [50] Thirdly, in addition to the risk being a substantial and illegitimate one, the weight of authority is that in deciding whether particular conduct is inappropriate under s 135, New Zealand courts will take an objective approach. See in particular *Fatupaito v Bates* [2001] 3 NZLR 386 (HC). There O'Regan J pointed out that where a company has little or no equity, directors will need to consider very carefully whether continuing to trade has realistic prospects of generating cash that will service both pre-existing debt and meet the commitments that such trading inevitably attracts.
>
> [51] The essential pillars of the present section are as follows:
>
> - the duty which is imposed by s 135 is one owed by directors to the company (rather than to any particular creditors);
> - the test is an objective one;
> - it focuses not on a director's belief but rather on the manner in which a company's business is carried on, and whether that *modus operandi* creates a substantial risk of serious loss;
> - what is required when the company enters troubled financial waters is what Ross (above at [48]) accurately described as a "sober assessment" by the directors, we would add of an ongoing character, as to the company's likely future income and prospects.

[158] Directors do not become liable simply because they trade a company while it is in an insolvent position. Such a situation gives rise to a distinct possibility that the

requirements of s 135 may arise. At that point, the company has entered the troubled financial waters. The position was described in the following way by O'Regan J in *Fatupaito v Bates*:

> [77] The important point is that when a company has negative shareholders' funds, the decision to keep trading is a decision which necessarily involves risk for creditors (both existing creditors and those which will arise from the future trading). While there may be circumstances where continued trading is justified by the prospect of collecting pre-existing debts or generating significant income from a reasonably minor expenditure (as in situations where projects are nearly completed and a small amount of work to complete them will justify payment of a full contract price), directors must be very cautious before embarking on that course.

[159] Similarly, in *Re South Pacific Shipping Limited (in liq)*, William Young J indicated, in addressing the question of legitimate and illegitimate business risks, that the following was a relevant consideration:

> [125] In determining whether a business risk is legitimate, a number of considerations may be material:-
>
> …
>
> 3. No-one suggests that a company must cease trading the moment it becomes insolvent (in a balance sheet sense). Such a cessation of business may inflict serious loss on creditors and, where there is a probability of salvage, such loss can fairly be regarded as unnecessary. The cases, however, make it perfectly clear that there are limits to the extent to which directors can trade companies while they are insolvent (in the balance sheet sense to which I referred) in the hope that things will improve. In most of the cases, the time allowance has been limited, a matter of months.
>
> …

The text in light of purpose

[160] The authorities referred to above explain some of the context and purpose of the section. The wording of s 135 should be considered in light of such features.

[161] First, it seems to me that paras (a) and (b) — "agree" and "cause or allow" — cover the ground of directors deciding to, or going along with decisions to, carry on business in the relevant manner. The following, then, seem to me to be significant aspects of the wording of the provision given its purpose:

(a) The section is concerned with risks to *creditors*, not risks to the company. A risk to the creditors will only arise if the company fails leaving a deficiency on liquidation. Some risk to creditors of this kind is inherent in the normal business risks taken by a company. The section is not focused on such normal business risks that companies are established to take, however.

(b) The section only refers to a *substantial* risk to the creditors. There is no requirement for it to be shown that it is more likely than not that that risk will materialise. But it means there must be a major or large risk. This means that there must be a major risk of the company failing with a deficiency on liquidation.

(c) That risk must be one that will *create* — that is cause or give rise to — *serious loss*. This contemplates a serious deficiency in a liquidation. A minor or modest loss is not relevant. The loss in issue must be a significant or major one and must be caused by the risk arising from the conduct in issue.

(d) The conduct in issue is the *manner* in which the business is being carried on. Thus, it is the way the business of the company is undertaken, and the decisions of the directors in relation to it, that must cause the substantial risk of serious loss. That is not limited to the question of whether to continue trading and can encompass other modes of undertaking business.

(e) Finally, the way that the business is being undertaken must be *likely* to cause the substantial risk of serious loss to creditors. That is, it must be more likely than not that the substantial risk of serious loss will be created by the manner in which the business is being operated. This is an important causal link between the manner in which the business is conducted and the qualifying risk of loss to the creditors.

[162] When these cumulative requirements of the wording of the section are considered, it can be seen that the section involves a reasonably high threshold that must be established before liability arises. The manner of trade must give rise to a substantial risk of company failure causing a deficiency in liquidation resulting in serious loss to creditors. Alternatively, the section can also apply if failure is already likely, but the manner of trade creates a substantial risk of additional serious losses to creditors in the liquidation.

[163] It has been said that there are differences between those who look at the literal wording of the provision, and those who focus on the distinction between legitimate and illegitimate business risk taking.[21] I am not convinced that there is such a dichotomy provided that the text is interpreted in light of its purpose. It seems to me that when directors take a risk meeting the requirements referred to above they are taking an illegitimate risk. Put another way, these aspects tell when the risk is an illegitimate one. The difficulty with using the concept of illegitimate risk as the touchstone of liability by itself is that it does not tell you precisely when risk taking is illegitimate.

[164] A substantial risk of serious loss to creditors will arise only when potential insolvency is in issue.[22] Directors who take risks when that is the case are really risking the creditors' money, not the shareholders' capital. If a company is insolvent, or close to insolvency, and the directors operate the company in a manner likely to create a substantial risk of serious loss to those creditors, that involves illegitimate risk taking.

[165] Section 135 is not intended to apply to the normal business risks taken by companies. The section is concerned with the risk to creditors, not risk to the company. Companies are risk taking entities, and have limited liability for this reason. This is referred to in para (a) and (d) of the long title to the Act. Some risk to creditors is inherent in such activities. The risk to creditors associated with the normal risks of

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[21] See *Jordan v O'Sullivan* HC Wellington CIV-2004-485-2611, 13 May 2008 at [40]–[43]; and *Re South Pacific Shipping Ltd (in liq)*, above n 13, at [129]–[130].

[22] That includes one-off transactions that place the entire company at a substantial risk of failure causing serious loss to creditors, even when solvency was not previously in issue before the transaction. See, for example, *Goatlands Ltd (in liq) v Borrell* (2007) 23 NZTC 21,107 (HC).

the company do not meet the requirements of the section. It is only when the risks that the company has been capitalised by the shareholders to engage in are clearly surpassed that s 135 is potentially engaged. The manner in which the business of the company is then undertaken must be "likely" to give rise to a "substantial" risk of "serious" loss to those creditors. In *Re South Pacific Shipping Ltd (in liq)*, William Young J included consideration of orthodox commercial practices as relevant to that assessment.[23] The overall scheme of the Act, and the norms it contemplates, are also relevant. Interpreted in light of the Act's overall purposes, it can be seen that the section is not concerned with the kind of business risks that the Act encourages people to engage in through the vehicle of a company. The substantial risk of serious loss is concerned with an abnormal/unreasonable risk. That is another way of saying the section is concerned with "illegitimate" risk taking.

[166] This goes back to the enduring policy underpinning referred to by the Law Commission. Whilst the section as enacted seems to have put the bar at a higher level, the underlying policy remains the same. It can be said that companies are essentially conglomerations of capital.[24] But when a company is technically insolvent, or near to that point, it is not really the shareholders' capital that is being risked any longer. In such a situation, the directors are risking the creditors' money. To treat the creditors' money as the capital of the business is not appropriate, and liability may follow if there is a substantial risk of serious loss to the creditors.

[167] In *Mountfort v Tasman Pacific Airlines of NZ Ltd*, Baragwanath J said "… the law must recognise that assessments of the ability of a company to survive are a matter of judgment and a substantial margin of tolerance must be allowed to directors to perform their function of taking legitimate risks".[25] That was in the context of his observation that the 1993 Act had changed the focus and that "solvency is now the condition of unconditional entitlement to trade".[26] The extent of the margin is likely to depend on the circumstances. In the end, it is the standards prescribed by the section that must be applied to the particular facts.

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23 *Re South Pacific Shipping Ltd (in liq)*, above n 13, at [125](4).
24 This is referred to in para (a) of the long title to the Act. See Susan Watson "Corporate Law and Governance" [2018] NZ L Rev 275.
25 *Mountfort v Tasman Pacific Airlines of NZ Ltd* [2006] 1 NZLR 104 (HC) at [25].
26 At [25].

[168] The section is not limited in its operation to decisions on whether to continue trading at all. The "manner" in which the "business of the company" is "being carried on" also contemplates other ways the company is being traded that give rise to a substantial risk of serious loss to creditors. The test is an objective one, and there is no requirement to show that the directors knew that they were operating the business in a manner likely to give rise to a substantial risk of serious loss to creditors. But they must "cause" or "agree" or "allow" infringing trading. Given the requirements, it would be surprising if directors had failed to recognise that the qualifying risk had arisen. The bar is set quite high. Whilst the title of the section — reckless trading — is not by itself an interpretive guide, the standards set by the section seem to me to require more than negligence, but risk taking when potential insolvency is involved, and substantial risk of serious loss to creditors is likely. Reckless trading is a fair overall description.

Maintaining adequate capital

[169] A key issue in the present case is Mainzeal's alleged balance sheet insolvency. In developing his submissions, Mr Hodder QC for the second to fifth defendants indicated that minimum capital requirements for companies had not been continued in the 1993 Act, and issues relating to the capitalisation of the company were matters for the shareholders and should not be transferred to become the directors' responsibility by an interpretation of s 135. Similarly, Mr Chisholm QC for the first defendant submitted that Mr Yan should not be held responsible for the capitalisation decisions of the shareholder.

[170] To the extent that these arguments were advanced to minimise the responsibilities of directors, I do not accept them. The Law Commission addressed the rationale for removing minimum capital requirements in its report, and this rationale appears to have been carried through into the Act. An independent minimum capital requirement would not protect against undercapitalisation but might penalise small traders. The Law Commission was of the view that the appropriate level of capitalisation depended on the nature of the business, and obligations on directors

(primarily those now contained in ss 135 and 136) were regarded as a more appropriate way of regulating solvency in a balance sheet sense. The Commission said:[27]

> The Law Commission considers that the dangers of undercapitalisation are better faced up to by imposing obligations upon directors who incur liabilities in the name of the company in such circumstances. The duties imposed upon directors in the draft Act in section 105 are an attempt to face up to this problem directly.

[171] These concepts were picked up by Baragwanath J in *Mountfort v Tasman Pacific Airlines of NZ Ltd*, where his Honour recorded:

> [20] … the "general obligation [under the former legislation] to maintain the company's capital" recorded by Richardson J in *Nicholson v Permakraft* at p 255 has now been superseded by what may be expressed as a general albeit imperfect obligation not to trade while insolvent, which is to be inferred from the whole scheme of the Act. The obligation to maintain solvency could not be absolute, because that would destroy the very justification for limited liability which requires the protection of directors who, acting reasonably and in good faith, are unable to prevent the failure that is both a regular fact of business life and the justification for limited liability. The obligation is imperfect because breach does not, per se, attract legal consequences for the directors. But it is nevertheless an obligation because it is the premise on which there is unconditional entitlement to continue to trade.
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> …
>
> [23] … On that approach either inability to pay debts or increase in liabilities over assets is a watershed: up until that point the company may lawfully expose its capital and assets to the risks of trade; after that the emphasis is on the position of creditors.
>
> …
>
> [29] As to what is a legitimate risk, one factor may be inferred from the legislation: while risk of adventitious events must be accepted, risks resulting from adoption of a systemic policy to trade while insolvent is another matter. As will later be seen, US courts will respond to the latter problem by piercing the corporate veil. I have concluded that it may be approached more directly under ss 271-2.

[172] Mr Hodder submitted that this analysis overstated the position, and he emphasised that the obligation to pay debts when they fell due was a far more significant component for assessing the directors' obligations. He argued that the judgment of Baragwanath J extended upon the analysis in the judgment of the Court of Appeal in *Commissioner of Inland Revenue v Chester Trustee Services Ltd*, which

[27] *Company Law: Reform and Restatement*, above n 17, at [226].

had been delivered by him for the Court.[28] That decision focused on the obligation to pay debts as they fell due, rather than balance sheet solvency. He argued that Baragwanath J was extending the concepts in a way that had not formed part of the earlier Court of Appeal reasoning.

[173] I do not accept Mr Hodder's arguments. Balance sheet solvency is a key aspect of the test of solvency precisely because it affects creditors in a highly relevant, but not necessarily immediate, way. I agree with the analysis conducted by Baragwanath J on the importance of balance sheet solvency. It is reflected in other reckless trading cases such as *Löwer v Traveller* and *Fatupaito v Bates*.[29] Indeed, a classic reckless trading situation is where the company is managing to pay immediate creditors, but is operating while balance sheet insolvent, and thus creating the substantial risk of serious loss to creditors. As Mr O'Brien QC argued for the plaintiffs, on the basis of the authorities referred to above, once the company becomes balance sheet insolvent, a significant issue arises that requires the directors to squarely consider their responsibility to creditors. It is the troubled waters requiring a sober assessment, the watershed referred to in those cases. A "systemic policy to trade while insolvent" may be particularly problematic.

[174] Mr Chisholm for the first defendant argued, in response to minutes I released during the course of the trial that I will explain in greater detail below, that there was no duty on directors to avoid liquidation.[30] As a self-standing duty of directors that is true. But it is possible that a substantial risk of serious loss can arise by creating a risk of failure through the manner in which the business of the company is undertaken. Section 135 is not directed only to a situation where the directors continue to trade a company when liquidation is unavoidable, thereby creating additional losses to creditors. It covers other circumstances where a substantial risk of serious loss arises.

Shareholder support

[175] In cases involving balance sheet insolvency, a question may arise concerning indications by the shareholders that further financial support is available. In *Re South*

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28 *Commissioner of Inland Revenue v Chester Trustee Services Ltd* [2003] 1 NZLR 395 (CA).
29 *Löwer v Traveller*, above n 12; *Fatupaito v Bates*, above n 14.
30 See [402]–[407] below.

Pacific Shipping Ltd (in liq), an argument was made that the directors should not face liability because of the prospect of shareholder support. William Young J did not see much merit in that suggestion on the facts of that case. He said:[31]

> [153] It follows that I am broadly in favour of the plaintiff on issues of liability and reject the counter-veiling arguments advanced by Mr Löwer. I should, however, address particularly some of the arguments advanced on behalf of Mr Löwer.
>
> 1. Mr Fardell for Mr Löwer argued that it was relevant to my assessment that, as at June 1994 (and thus necessarily at April 1994), Mr Löwer believed that there was no serious risk of insolvency because he considered that he himself would be able to inject whatever funds would be necessary to ensure that trading continued. Arguments along these lines should be viewed sceptically; this as a matter of policy. Mr Löwer's liability does not depend upon his subjective assessment of the position. In any event, as at the middle of 1994, Mr Löwer's belief that he would, if necessary, in the future, inject further funds into SPS was, as he should have recognised, a flimsy basis for continuing to trade. It left the company and its creditors completely exposed to the risk that Mr Löwer might change his mind (as in the end, he did). Mr Löwer must have recognised this risk from the latter part of 1994 because he resolutely refused, despite advice from Mr Russell, to give any commitment as to future funding and thus preserved for himself the opportunity to change his mind.
>
> …

[176] I also note the observations of Baragwanath J in *Mountfort v Tasman Pacific Airlines of NZ Ltd*, albeit it in connection with pooling orders under s 271 of the Act, which are also potentially relevant to the circumstances of the present case. He referred to the following:

> [89] … If the holding company removes funding which would permit the subsidiary to survive independently of it, or causes or permits the subsidiary to trade while insolvent, it is putting at risk the subsidiary's creditors, again in breach of the solvency requirements.

[177] On the other hand, in *Jordan v O'Sullivan*, the High Court accepted that anticipated shareholder support was one of the reasons why the directors did not engage in conduct contravening ss 135 or 136.[32] By reference to s 136, Clifford J held:

> [59] Section 136 does not appear to require that the company's ability to meet the obligation arises from the company's separate resources, as long as the director believes on reasonable grounds that the company will be able to do so. Therefore, it would appear that a director who believes, on reasonable

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31 See also *Nicholson v Permakraft (NZ) Ltd*, above n 19, at 249 per Cooke J.

32 See also *Morgenstern v Jeffreys* [2004] NZCA 449 at [121].

> grounds, that the obligation will be met by means of shareholder or director contributions will not breach the duty. That s 136 will not be breached if director contributions are reasonably anticipated is implicit in the judgment of Paterson J in *Ocean Boulevard Properties Ltd v Everest* (2000) 8 NZCLC 262,289. In concluding that s 136 had been breached, Paterson J noted at [10] that "[i]t must be inferred that the directors did not have the intention or the capacity to contribute funds for the conduct of a business".

[178] And then later when explaining why he reached the conclusion that none of ss 135, 136 and 137 had been contravened:

> [247] In this regard, I think appropriate consideration has also to be given to the stated willingness of the defendants, and Mr O'Sullivan in particular, to provide capital to [the company] should the need arise. It goes without saying that such a commitment is easy to assert but may provide more illusory in reality. Here, however, the substance of the defendants' willingness to provide additional capital, in the context of their decision to expand [the company's] business by entering into the Specified Leases, can to some extent be measured against their conduct. They had, as recently as October 1999, provided additional capital to [the company] in light of the implications for [the company], by that time, of its policy as regards the CPI Advances. That action does, in my judgment, give a measure of substance to their commitment to [the company].
>
> …
>
> [254] … That in hindsight [the directors] under-estimated the risks involved in the start-up phase of each of those lease operations is not, in my judgment, a sufficient basis in this case to conclude that they breached the duties they owed to [the company]. In reaching that conclusion, and as regards the capitalisation of [the company], it is important here that the directors had, very recently and in their capacity as shareholders, demonstrated a willingness to support the company's trading by the provision of further capital.

[179] As will be apparent when I come to consider the application of s 135 to the present case, these observations are relevant. Extracting funds from a subsidiary can give rise to the subsidiary trading while insolvent, which puts the subsidiary's creditors at risk, potentially raising a breach of the duty under s 135. And promises that the shareholders will nevertheless provide support when necessary need to be assessed carefully in light of the obligations arising under s 135 and the particular facts and circumstances of the case.

Interests of the group

[180] A further relevant feature of the present case is that Mainzeal was a company that operated within a wider group. I accept the argument advanced by Messrs Hodder

and Chisholm for the defendants that, when that is the case, it is not appropriate to consider the position of the company in an isolated way. It is important to look at how a company fits in with its broader group, including in relation to matters such as its capital and maintaining its solvency. This point is closely related to the point just addressed in relation to shareholder support.

[181] The overall scheme of the Act recognises the significance of a company operating within a broader group. Section 131 of the Act provides:

> **131 Duty of directors to act in good faith and in best interests of company**
>
> (1) Subject to this section, a director of a company, when exercising powers or performing duties, must act in good faith and in what the director believes to be the best interests of the company.
>
> (2) A director of a company that is a wholly-owned subsidiary may, when exercising powers or performing duties as a director, if expressly permitted to do so by the constitution of the company, act in a manner which he or she believes is in the best interests of that company's holding company even though it may not be in the best interests of the company.
>
> …

[182] One of the key aspects of s 131(2) is that it only arises when the subsidiary company in question is a wholly-owned subsidiary. This is a legislative recognition that sometimes subsidiaries, whilst created as separate legal entities, can operate as a division of a larger group. In such situations, the holding company's capital base can mean that the subsidiary can operate with less concern about maintaining its own capital and independent solvency. But it is important that s 131(2) does not oust the operation of ss 135 and 136. Section 131(2) is permissive only. Directors cannot act in this way if this results in a breach of their duties under ss 135 or 136.[33] So the legitimacy of proceeding in a way that would not be appropriate for an independent company will depend on the facts and circumstances.

[183] Another related concept is that, under s 271(1)(a) of the Act, the Court has a power to require a company that is related to a company in liquidation to pay the whole

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[33] *Kings Wharf Coldstore Ltd (in rec and in liq) v Wilson* (2005) 2 NZCCLR 1042 (HC) at [107].

or part of any claims in the liquidation. So, if the Court were satisfied that it would be just and equitable, a holding company could be obliged to contribute if its wholly-owned subsidiary went into liquidation. The link between ss 135 and 271 was recognised by Baragwanath J in *Mountfort v Tasman Pacific Airlines of NZ Ltd*.[34] A holding company could be legally required to contribute to protect the interests of the subsidiary's creditors. The extent to which a holding company is subject to the reach of New Zealand law, including s 271, might be a relevant consideration under ss 135 and 136 when assessing the reasonableness of reliance on shareholder support.

[184] Prior to a restructuring in 2008/09, Mainzeal was a wholly-owned subsidiary of Richina Pacific. But, from 2003, Richina Pacific was a company registered in Bermuda rather than New Zealand (although it was registered as a foreign company under Part 18 of the Act from that time). The definition of "company" in s 2 of the Act only contemplates a company registered under Part 2 of the Act — in other words, it only applies to New Zealand companies. But under s 5(3), the definitions of "holding company" and "subsidiary" are extended to include a "body corporate", and thus an overseas incorporated company such as Richina Pacific.[35] Therefore, s 131(2) applied to the relationship between Mainzeal and Richina Pacific itself when Mainzeal was a wholly-owned subsidiary of Richina Pacific, but not afterwards.

[185] But the extended meanings of subsidiary and holding company do not apply to s 271, meaning that such an overseas company cannot be required to contribute on insolvency. So here Richina Pacific could not be required to contribute to Mainzeal's liquidation under s 271.

APPLICATION OF SECTION 135 TO THIS CASE

[186] The plaintiffs contend that the directors breached their duty under s 135. They allege that the directors had a duty to consider the position of Mainzeal's creditors from 31 December 2008, or alternatively from 31 January 2011 or 31 July 2011. They say that the directors acted improperly by continuing to trade Mainzeal from the 2011 dates when they contend it was balance sheet insolvent, and relied purely on verbal

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34 *Mountfort v Tasman Pacific Airlines of NZ Ltd*, above n 25.

35 See Companies Act 1993, s 2 definition of "overseas company", which refers to "a body corporate that is incorporated outside New Zealand".

assurances of support. By contrast the defendants contend that there was nothing inappropriate in the directors continuing to trade, and that it is normal for a company forming part of a wider group to rely on assurances of support from other companies in that group.

[187] In my view, the application of s 135 to the present case depends on a close consideration of the particular facts and circumstances. For reasons explained in detail below, I have reached the conclusion that the directors acted in breach of their duties under s 135. Whilst all the factors I address below are relevant, there are three key considerations that cumulatively lead me to conclude the duties in s 135 were breached:

(a) Mainzeal was trading while balance sheet insolvent because the intercompany debt was not in reality recoverable.

(b) There was no assurance of group support on which the directors could reasonably rely if adverse circumstances arose.

(c) Mainzeal's financial trading performance was generally poor and prone to significant one-off loses, which meant it had to rely on a strong capital base or equivalent backing to avoid collapse.

[188] Each of these three features is necessary to establish liability in this case. The absence of any one of them would be detrimental to the liquidators' claim. The policy of trading while insolvent is the source of the directors' breach of duties, however, such a policy would not have been fatal if Mainzeal had either a strong financial trading position or reliable group support. It had neither.

[189] It will be necessary to address these three related features in greater detail, and I do so below. Some of them will require a greater degree of analysis than others. There are also other considerations related to these three key features that I have taken into account. But ultimately it is these key features that give rise to my conclusion that s 135 was breached.

Policy of Trading Whilst Insolvent

[190] First, the directors adopted a policy of trading whilst balance sheet insolvent.

Was Mainzeal insolvent?

[191] The suggestion that Mainzeal traded whilst insolvent was disputed by the directors. The test of solvency under s 4 of the Act contemplates two ways in which insolvency can arise — when the company is not able to meet its debts as they fall due, or when the company's liabilities exceed its assets. Both potential grounds were advanced by the plaintiffs in the present case, albeit it seems to me that the second basis of insolvency — that the company's liabilities exceeded its assets — is of more central significance, as the failure to pay debts as they fell due only occurred later in time.

[192] Under s 4(1)(b) a company fails the insolvency test if its assets are not greater than its liabilities. If, however, the liabilities are greater than its assets it is in a deficit position, described as balance sheet insolvency. The starting point for that assessment will be the balance sheet in the company's accounts.[36] But the accounts alone may not give the full picture — the accounts may record the company has an asset when in truth the asset is over-valued in the accounts. Section 4(2)(a)(ii) requires the directors to have regard to "all other circumstances the directors know or ought to know affect, or may affect, the value of the company's assets …" when determining whether the company is balance sheet solvent.

[193] Here I accept the evidence of Mr Apps and Mr Bethell that Mainzeal was insolvent on a balance sheet basis from as early as 2005. In particular, the related party debts were owed by companies within the Richina Pacific group that were not in a position to repay them to Mainzeal. That was particularly so with respect to MLG, but it was also the case in relation to RGREL. The absence of a legally binding commitment from Richina Pacific meant that the loans were not recoverable. If these loans are treated as not recoverable, then Mainzeal's liabilities well exceeded its assets.

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[36] Companies Act 1993, s 4(2)(a)(i).

[194] The position was outlined in the following table produced by the plaintiffs, which demonstrates the impact of deducting the "related party receivables" — the loans — from the balance sheet:

Adjusted net asset position								
As at 31 December	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Current assets	84,196	72,669	74,381	74,781	84,315	107,734	87,926	97,370
Current liabilities	(86,686)	(67,182)	(63,130)	(59,397)	(66,452)	(84,578)	(98,091)	(123,712)
Net working capital	(2,490)	5,487	11,251	15,384	17,863	23,156	(10,165)	(26,342)
Non-current assets	44,053	12,289	17,826	13,584	13,347	8,758	37,977	38,235
Non-current liabilities	(41,011)	(2,429)	(2,621)	(7,740)	(6,699)	(5,644)	(8,704)	(5,655)
Reported net assets (parent)	**552**	**15,347**	**26,456**	**21,228**	**24,511**	**26,270**	**19,108**	**6,238**
Less: RGRE (RLL)	(12,683)	(14,604)	(14,719)	(11,169)	(11,787)	(11,964)	(14,504)	(131)
Less: MLG	(20,260)	(22,173)	(24,679)	(27,936)	(30,321)	(30,030)	-	-
Less: Prepaid Building Materials	-	-	-	-	-	-	(33,346)	(27,037)
Less: KF(NZ)L	-	-	-	(300)	(689)	(954)	(1,719)	(15,018)
Less: KFL	-	-	-	-	-	(1,106)	(5,617)	(6,548)
Less: MLL	-	-	-	-	-	-	(537)	(1,716)
Less: MGL	-	-	-	-	-	-	-	(17,109)
Plus: Midland Tower payable forgiven	37,301	-	-	-	-	-	-	-
Less: shares in subsidiary written off	(30,000)	-	-	-	-	-	-	-
less: related party and intercompany accounts	**(25,642)**	**(36,778)**	**(39,398)**	**(39,405)**	**(42,797)**	**(44,054)**	**(55,723)**	**(67,559)**
Adjusted net assets	**(25,090)**	**(21,431)**	**(12,942)**	**(18,177)**	**(18,286)**	**(17,784)**	**(36,615)**	**(61,321)**

[195] In all recorded years, the balance sheet is in deficit if the related party receivables of MLG and RGREL are excluded. The last years in this table are complicated by the existence of the Pre-Paid Goods Agreement, and the restructuring transactions in 2012.

[196] Mr Hodder argued that Mainzeal was not balance sheet insolvent because the directors reasonably understood the assets of the group to be available to Mainzeal, and he emphasised that the auditors had signed off the annual accounts. He contended that this meant that the company was solvent. But no expert evidence was led by the defendants to this effect, nor did the defendants' experts take issue with the evidence of Messrs Apps and Bethell on this point. Mr Grant Graham was the defendants' expert accounting witness, and he did not give such evidence. Neither did their audit expert, Professor van Zijl. The defendants also led evidence from their corporate governance expert, Mr Richard Westlake, that the company was balance sheet insolvent, a view that he repeated in cross-examination.

[197] The fact that the auditors signed off the accounts does not mean they had assessed that the company was solvent. It was the directors who represented to the

auditors that the related party receivables were recoverable during the course of the audits. The auditors then accepted the accounts represented a true and fair view of the company's financial position prepared on the going concern assumption. Professor van Zijl suggested comfort could be taken from the fact that the auditors had accepted that Mainzeal was a going concern, but he did not suggest that this assessment meant that the auditors had concluded that the company was solvent. As I will address in greater below, whether a company is a going concern is a different question from whether it is balance sheet solvent.[37] The latter matter is for the directors.

[198] Moreover, the "emphasis of matter" note to the accounts required by the auditors emphasised that even the validity of the going concern assumption depended on group support.[38] The previous auditors, PwC, had stated in the 21 November 2008 report on the delisting that "Mainzeal's balance sheet is in a deficit position (excluding its intercompany advances) and requires the support of the [Richina Pacific] Group to operate in the short term". This accurately described the position. The contemporaneous documents also suggest that it was recognised at the time that the company was balance sheet insolvent. For example, Mr Gomm's Chief Executive Officer reports to the Mainzeal board addressed the key performance indicators, one of which was the balance sheet, which sometimes reported that the balance sheet was in deficit by some USD 10 million.

[199] Once a company is insolvent in a balance sheet sense, that does not mean that the directors are obliged to stop trading. As William Young J said in *Re South Pacific Shipping Ltd (in liq)*, "No-one suggests that a company must cease trading the moment it become insolvent (in a balance sheet sense)".[39] But as Baragwanath J said in *Mountfort v Tasman Pacific Airlines of NZ Ltd*, this is a "watershed: up until that point

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37 At [259] – [263].

38 Professor van Zijl also noted that the auditors' "emphasis of matter" note did not correspond to the directors' note on "Continued shareholder support" in the annual accounts. This note recorded the directors' view that Mainzeal had adequate resources to continue for the next 12 months, as well as recording that it had group support. The auditors' "emphasis of matter" stated that the validity of Mainzeal being treated as a going concern depended on the group support. Although Professor van Zijl said this difference appeared not have been material for audit purposes, given the auditors issued an unqualified opinion, it is nevertheless clear that the auditors implicitly did not accept the other limb of the directors' note — that Mainzeal could trade on its own resources.

39 *Re South Pacific Shipping Ltd (in liq)*, above n 13.

the company may lawfully expose its capital and assets to the risks of trade; after that the emphasis is on the position of creditors".[40]

[200] Mainzeal's case did not involve a minor or technical state of insolvency. The balance sheet was in deficit by very substantial amounts. Moreover, there is the added dimension that insolvency was not a transient or temporary state. It was continuous. Mainzeal was adopting a policy of insolvent trading of the kind referred to by Baragwanath J.[41]

[201] As Mr Hodder rightly contended, however, balance sheet insolvency has less immediate significance than insolvency arising from the company failing to meet its debts as they fall due. As he argued, it is the latter concept of insolvency that is contemplated by Part 16 of the Act, and which is accordingly of far greater significance. Nevertheless, balance sheet insolvency is significant, precisely because it can give rise to such failure, particularly when this status is adopted as part of the ongoing manner in which the company conducts trade. To the extent that Mr Hodder contended otherwise, I reject his submission for the same reasons already given above at [172]–[173].

[202] I nevertheless accept Mr Chisholm's argument that simply continuing to trade a company in an undercapitalised state does not necessarily cause any loss to the company. It does not establish a breach by itself. The directors could still legitimately say that they were not exposing the creditors to a substantial risk of serious loss as they had other reasons for confidence that the creditors' position was properly protected.

Using creditors' funds as working capital

[203] There is a closely related consideration. Mainzeal had an annual turnover of approximately $270–$380 million. A company with that turnover would not normally be able to operate while balance sheet insolvent as it would not likely have working capital. But it is a recognised feature of the construction industry that companies are

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40 *Mountfort v Tasman Pacific Airlines of NZ Ltd*, above n 25, at [23].

41 At [29].

able to obtain payment from contractual principals in advance of paying sub-contractors.[42] This very significant cash flow advantage existed for Mainzeal and gave it what was effectively working capital. But this working capital comprised creditors' funds — Mainzeal was literally trading with the sub-contractors' money. This money was at risk in place of share capital. The sub-contractors have been left with $45.4 million owed to them in the liquidation.

Reliance on group support

[204] It is suggested that the directors were able to properly trade notwithstanding the above factors because of the expectation of group support. It is necessary to consider the issue of group support in some detail. On the facts of this case the group support is a critical factor to the assessment of whether there was a substantial risk of serious loss to the creditors.

[205] The defendants emphasised that Mainzeal was part of a wider group. Mr Hodder argued that one cannot simply apply the dicta from *Re South Pacific Shipping Ltd (in liq)*[43] and *Fatupaito v Bates*[44] concerning the continued operation of a company during balance sheet insolvency, or circumstances close to insolvency, without due recognition of the circumstances arising in relation to a more significant group of companies where the group otherwise holds significant assets. The defendants emphasised that, as Mainzeal was part of a wider group, it was permissible to rely on the group to supply support to deal with any issues arising from any balance sheet insolvency. A number of the witnesses referred to the common practices of companies within a broader group operating on this kind of basis without undue concern. For example, it was referred to by Sir Paul, and emphasised by Mr Westlake. Richina Pacific was a major company, and any failure of Mainzeal would have had significant impacts on its reputation and share price.

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42 Note that these funds are different from those addressed by Parliament in s 18 of the Construction Contracts Amendment Act 2015. Although this legislation was prompted by Mainzeal's failure, it was directed to funds that are retained from contractual payments. Such retentions can be significant, but are a more restricted category of funds. The use of creditors funds as working capital arises from the delayed payment of the entire amount owing to a party such as a sub-contractor (in other words, it includes amounts that were not retained).

43 *Re South Pacific Shipping Ltd (in liq)*, above n 13.

44 *Fatupaito v Bates*, above n 14.

[206] I accept that in such situations it is not appropriate to look at the company in isolation. It is important to have regard to its place as part of a broader group, where the group's overall resources and policies will be relevant to assessing the particular company's position, and the directors' performance of their duties. That is legislatively contemplated by s 131(2).

[207] Here, the extraction of significant monies by way of loans for the benefit of Richina Pacific was not in Mainzeal's best interests. The loans were extracted through entities that could not themselves repay them. This is an illustration of the power a holding company can exercise through the provisions of the Constitution, in the manner contemplated by s 131(2) of the Act. This can be regarded as permissible and contemplated by the Act. The significant related party loans had been extracted from Mainzeal as if it was a trading division of Richina Pacific. Neither was this a one-way street, as Richina Pacific had provided financial support for Mainzeal in connection with Mobil on the Park, Vector Arena and in other respects, and it provided representations in connection with the annual accounts, including in its letter of 7 May 2008 with respect to the period of 12 months through to May 2009. There is evidence of other cash support during this period. That substantial support also included the provision of construction bonds, or guarantees for such bonds, for Mainzeal's construction contracts.

[208] Directors of a balance sheet insolvent subsidiary may continue to trade without breaching s 135 in circumstances where they have a reasonable basis to conclude that a solvent related company, such as a holding company, will protect the interests of the creditors notwithstanding that the subsidiary is trading whilst insolvent. That may well be the case when the subsidiary is part of a wider group, and the subsidiary is simply treated as a division of an overall group enterprise, and where the directors have a reasonable basis for concluding that necessary support is available from the wider group. That is not to say that the situation should not be treated with care to ensure that the requirements of s 135 do not arise. But continuing to trade in those circumstances may not, by itself, give rise to liability. It depends on the circumstances.

[209] The critical issue, therefore, is whether the expressions of support from Richina Pacific were sufficiently clear and reliable to mean the directors did not breach their

duties by relying on them. For a series of related reasons, I conclude that they were not.

Not clearly formulated

[210] First, with the exception of the letters of comfort provided for the annual audit, the expressions of support were not set out in clear terms in writing. Given the importance of the assurances for the legitimacy of Mainzeal's continued trading in an insolvent state, the reliance purely on verbal assurances was unreasonable. Verbal assurances have far less clarity than formal written documentation. Moreover, there had been a formal recording of the arrangements between Richina Pacific and Mainzeal in the form of the Charter and the associated letter from Mr Lobb in 2004. These formal arrangements not only provided no written assurance of support, but also stated that any requirement for financial support in the form of further capital would depend on the other competing demands of the group.[45] Thus, the written arrangements between the parties were inconsistent with a clear assurance of support whenever it was needed. Then in April 2009 the Mainzeal board minutes recorded that it was told that it was now to be self-sufficient, and the Richina Pacific board recorded that the only exception was the continuance of availability of construction bond support.

[211] Letters of comfort were provided by Richina Pacific entities in connection with the annual audit. To the extent that the directors relied on these, I do not think the reliance was reasonable. First, such letters were provided for the purposes of audit only, and it is not suggested they were legally binding. Furthermore, following the restructuring, these letters did not come from Richina Pacific itself, but from Richina (NZ) LP, an entity that did not itself have significant assets. Moreover, in late 2010, a decision appears to have been made by Richina Pacific not to provide expressions of support from CHC. None of these issues concerning the letters were focused on by the directors. In those circumstances, the level of support arising from such written materials was unclear, and it was not reasonable to place reliance on them.

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45 There is one line in the letter that can be read to the opposite effect, but the overall meaning of the letter is clear.

Conditional

[212] The second main point is that Richina Pacific's expressions of support were never suggested to be of an unlimited kind. As indicated, there were differing levels of enthusiasm amongst the Richina Pacific shareholders, some of whom were not keen on investing in a construction company in New Zealand. The qualified nature of the support was alluded to in the Richina Pacific annual reports. Mr Gomm gave evidence that, when he joined Mainzeal as Chief Operating Officer in 2007, Mr Yan said he had even considered shutting Mainzeal down, although he decided to commit to it instead. Even in his own evidence, Mr Yan indicated that the intention was to support Mainzeal, but only while it remained a going concern.

[213] In addition, whilst Mainzeal and Richina Pacific appeared to have common ultimate shareholders — which included Mr Yan himself — those common ultimate shareholders did not identify themselves as providing a guarantee of support. The ultimate shareholders were largely anonymous. There was no clear expression of support from these common ultimate shareholders even though Mr Yan represented the majority grouping. Had the directors probed this question more extensively, the nature of the limits on any intention to support Mainzeal may have become clearer. No such effective probing occurred. In any event, it was unreasonable for the directors to conclude that the support was unlimited, or to rely on such support without understanding its limits.

Not binding

[214] The third point is that the expressions of support were not in a legally binding form. Indeed, it would appear that the group had made efforts to ensure that any demands made on it by Mainzeal were not legally enforceable. As indicated above, the directors of a wholly-owned subsidiary can continue to trade notwithstanding balance sheet insolvency because of support from the wider group, or other third parties. But as Chapman Tripp advised in December 2012, there are circumstances where directors need to ensure that third party commitments on which they are relying are in legally enforceable form. The circumstances here suggested a legally binding commitment may have been necessary. Only a legally binding commitment could protect the creditors in an insolvency.

The limitations of Chinese law

[215] The fourth point is that the expressions of support relied upon by the directors, even if legally binding, were affected by another significant issue. I accept that Richina Pacific clearly had the assets to provide necessary support. But even if I were to accept that there had been clear commitments of support that were legally binding, or could otherwise be relied on, Chinese regulation could have prevented Richina Pacific from providing such support. To some extent this ultimately contributed to Mainzeal's failure in 2013. Mr Yan said things moved too quickly, and he was simply unable to get capital out of China to provide the support that was necessary to prevent Mainzeal from collapsing.

[216] In my view, the directors needed to ensure that the expressions of support, even if provided in legally binding form, would be effective given the limitations of Chinese law. Richina Pacific needed to be both willing and able. I accept the evidence of Mr Finny, an experienced company director who has considerable direct experience with conducting business in or with China, and who was New Zealand's lead negotiator of the China-New Zealand Free Trade Agreement between 2004 and 2005. He explained that the ability to remove funds from China was heavily controlled by Chinese authorities, including SAFE. He said that such authorities were unlikely to be impressed by applications to transfer funds to loss making subsidiaries, and this would be one of the highest risks facing a company such as Mainzeal. He said that, had he been a Mainzeal director, he would have been asking for regular updates and insisting on hard evidence of strong connections in China that would lead to the ability to receive funds. I accept this. The directors did not take such steps.

The support that was provided

[217] A feature stressed by all the defendants, and also by Mr Westlake, was that Richina Pacific had provided substantial support to Mainzeal over the years. Mr Yan emphasised that this had occurred, and that Mainzeal had survived because of the support. There was said to have been a pattern of behaviour that demonstrated that the support was reliable. It was argued by the defendants that reliance on the expressions of support from Richina Pacific was accordingly reasonable.

[218] It does not appear, however, that Richina Pacific was providing financial support to the extent the directors appeared to think. The following table was produced by Mr Bethell for the plaintiffs recording the intercompany balances, and I accept that it correctly analyses the annual cash flow movements between Mainzeal and the group over the relevant years.[46]

Reference	BDO.007.0020	BDO.007.0021	BDO.007.0022	BDO.007.0023	BDO.007.0023	BDO.007.0011*
Period	**Dec-06**	**Dec-07**	**Dec-08**	**Dec-09**	**Dec-10**	**Dec-11**	**Dec-12**

Reference		BDO.007.0020	BDO.007.0021	BDO.007.0022	BDO.007.0023	BDO.007.0023	BDO.007.0011*
Period	Dec-06	Dec-07	Dec-08	Dec-09	Dec-10	Dec-11	Dec-12
MLG Trading Ltd (converted to Prepaid Building Materials in FY11)	22,173	24,679	27,936	30,321	30,030	(206)	(5,642)
Richina Global Real Estate Ltd	14,604	14,719	11,169	11,787	11,964	14,504	131
Mainzeal Group Ltd	0	0	0	0	0	0	17,109
King Façade Ltd (Richina Land Ltd)	0	0	0	0	1,106	5,617	21,566
King Façade (NZ) Ltd	0	0	300	689	954	1,719	0
Waiheke Developments Ltd	0	0	0	0	247	1,277	2,395
Richina Ltd	0	0	0	1,479	259	0	0
200 Vic Ltd	0	0	0	0	0	2,515	2,784
Mainzeal Living	0	0	0	0	0	448	1,716
Mainzeal Living Homes LP	0	0	0	0	0	89	0
MWH MZ Joint Venture Ltd	0	0	0	0	0	1,047	0
Richina Pacific Investments (China) Ltd/ Richina Finance Ltd	0	0	0	0	(1,129)	(6,421)	(6,017)
Mainzeal Project Services Ltd	(561)	(347)	(202)	(323)	(175)	(304)	(310)
Total Related Party Balance	**36,217**	**39,051**	**39,204**	**43,952**	**43,257**	**20,286**	**33,731**
Richina Pacific Investments (China) Ltd - Prepaid Building Materials	0	0	0	0	0	33,346	27,037
Total Related Party Balance (including Prepaid Materials)	**36,217**	**39,051**	**39,204**	**43,952**	**43,257**	**53,632**	**60,769**

* Prepaid Building Materials and King Façade Ltd have been adjusted by $6.1m to account for the prepaid building materials received by MPC that was not accounted for in the December 2012 management report.

[219] The entries for 2006–2011 are all from the audited annual accounts, and they are not realistically disputed. They demonstrate that the movement of monies was generally out of Mainzeal and to the group. I accept that there were more temporary cash movements into Mainzeal from the group not captured by the annual figures. There is evidence of such temporary cash support. For example, internal documents suggest that in 2006 over $2.5 million was provided, which was mostly repaid within that year. There was also support through the supply of materials prior to the Pre-Paid Good Agreement being entered.

[220] But otherwise the figures speak for themselves. It is incorrect to say that Richina Pacific was providing Mainzeal significant financial support during the years 2006–2011. It was generally the other way around. Had substantial financial support of more than a temporary kind been provided by Richina Pacific, it would have

46 I note that the amounts owed by 2012 are not recorded in audited accounts and are complicated by inter-company dealings. I am not confident that the total related party debt necessarily grew to $60,769 million by December 2012.

appeared in the accounts. By 2010, the group owed Mainzeal $43.257 million. That was a significant amount, even allowing for the fact that a significant part of this was accumulated interest. The Pre-Paid Goods Agreement was entered into with effect in the 2011 financial year as a means of reducing this debt. The supply of goods under the Agreement was of significant value. But even with the reduction in the intercompany debt arising from the implementation of this agreement, the overall indebtedness to Richina Pacific was not reduced.

[221] The second factor of significance on this issue is that the Richina Pacific group was extracting more funds for the benefit of the group from Mainzeal than recorded in the audited annual accounts. It appears that where the temporary cash flows were properly recorded, they demonstrate that Richina Pacific was extracting further funds during the course of the financial year, but then returning the funds just before the end of that year. This was to restore the related party balances to a lower level for the purposes of the accounts. The register of cash flows that the board had required demonstrates that in 2010 and 2011 substantial funds were restored back to Mainzeal at the very end of December, with some then extracted out again in the following January. So, on 31 December 2010 — literally the last day of the financial year — an amount of $5.3 million was transferred into Mainzeal's accounts restoring the balance of the year to a positive number. But $4.6 million was extracted in the following January. On 31 December 2011, the same pattern emerged with $6.4 million transferred into Mainzeal on that date, and a net value of $1.2 million extracted through to April the following year. That is consistent with the document provided to the board of Mainzeal for its meeting on 19 November 2010 that "[a]ll available cash [was] to [be] deposited with Mainzeal at half year and year end for window dressing purposes".

[222] On the other hand, I accept that there are two factors that support the defendants' case that financial support was provided, and reliance on Richina Pacific support was reasonable. First, Richina Pacific had provided support for the construction bonds, either by providing the bonds itself, or by guaranteeing the performance of the bonds. This was of particular significance as Richina Pacific faced a very significant contingent liability if Mainzeal failed. Mr Walker explained that its ultimate liability on Mainzeal's failure in relation to the guarantee of construction

bonds was in the order of $19 million. The bonds or guarantees provided by Richina Pacific were generally higher than this. At liquidation Richina Pacific was additionally liable for $10.54 million in relation to bonds it had itself provided. The existence of this bonding support gave Richina Pacific a very strong incentive to continue to support Mainzeal.

[223] Whilst the directors referred to the bond support provided, none of them referred in their evidence to the consequential implications this had for the expectation of continuing support. In some ways, however, this is the defendants' best point. The Court assesses s 135 objectively, and objectively this provides some basis for a reasonable expectation of support.

[224] The second related factor is that substantial financial support, in the order of $11.6 million, was provided by Richina Pacific during 2011/12 in an attempt to assist Mainzeal. This is very substantial financial support. In my view, it is closely related to Richina Pacific's contingent liability under the construction bonds, as it made sense for Richina Pacific to attempt to avoid the liability under the bonds by providing further substantial assistance. Obviously, the assistance proved insufficient to prevent Mainzeal's collapse.

[225] These two related features support the defendants' case. But they do not by themselves demonstrate that the directors met their duties under s 135. Without a legally binding commitment, or even a clearly articulated one, such support was always ultimately at the option of the Richina Pacific group. It was never assured.

Effect of restructuring

[226] The unreliability of group support became particularly acute after the 2008/09 restructuring and separation. Some of the features that call into question the dependability of the support were in existence when the group structure was put in place from 2004 but in my view, the circumstances changed in a material respect following the restructuring between the end of 2008 and the end of 2009. At this point, reliance on the informal expressions of support became unreasonable.

[227] The whole point of this restructuring was to delist Richina Pacific, and to separate out the New Zealand and Chinese divisions. In part, this was because of the lack of enthusiasm for supporting Mainzeal amongst some of the ultimate shareholder group. This is so even though the separation was not as extensive as first planned. Mainzeal was no longer a subsidiary of a publicly listed Richina Pacific, and whilst they had common ultimate shareholders (Mr Yan and others) they were also then no longer directly within the same immediate group. The May 2009 board report for Richina Pacific recorded that Mainzeal was now to be regarded as "financially self-sufficient from [Richina Pacific]" with the "one exception" being the guarantee of the construction bonds. It is clear that this was a very significant change. From this stage, the potential issues became very real and significant issues in practice. After the restructuring:

(a) the New Zealand operations were separated from the Chinese operations to introduce greater independence, and the Mainzeal directors were instructed to operate more independently;

(b) Richina Pacific was no longer listed on the New Zealand Stock Exchange;

(c) the annual audit letters of comfort no longer came from Richina Pacific;

(d) the companies that owed the intercompany receivables on which solvency depended were no longer subsidiaries of Richina Pacific, and they could not by themselves repay; and

(e) Mainzeal was no longer a wholly-owned subsidiary of Richina Pacific in the manner contemplated by s 131(2).[47]

[228] The fact that the promised capitalisation on separation did not occur is of significance. The significant hole in Mainzeal's balance sheet would have been filled,

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[47] And as a consequence of Richina Pacific's earlier move to Bermuda, Richina Pacific was beyond the reach of New Zealand law, including s 271.

and its status as insolvent would have been remedied. But the capitalisation did not proceed.

[229] I have accepted Mr Schubert's evidence that he lost faith in Mr Yan at this point. PwC were subsequently removed as auditors of the New Zealand companies. The concerns raised by Mr Schubert seem to me to be the kind of concerns that should have arisen for the directors of Mainzeal. Mr Yan said that the auditors were changed for cost saving purposes. But I accept that, at least in part, PwC's questioning of the arrangements contributed to the decision to remove them as auditors.

[230] From this point the balance sheet insolvency could not be dismissed as a technical issue only. From at least 1 January 2010, Mainzeal was trading while insolvent in a highly material way. As indicated above, this does not mean that liability under s 135 necessarily arises. The directors in this situation might still have traded on if they had made a sober assessment, and reasonably decided to do so. I do not think such a sober assessment was made, however. I accept the evidence of the plaintiffs' corporate governance expert, Mr Samford Maier, in this respect. He has had considerable directorship experience, including through a directorship with Mainzeal's main competitor, Hawkins. He also had significant experience with trading on insolvent companies, and explained that extreme care was necessary when embarking upon that exercise. He was critical that the directors of Mainzeal had never really properly appreciated the risks they were engaging in. He was prepared to give them the benefit of the doubt for a period of time through to the end of 2010, before expressing the view that the directors were acting improperly in continuing to trade Mainzeal in this way from the end of January 2011. His evidence was that, by that stage, he would have been "climbing up on the [board] table" given the state of the risks.

Requests for clarification

[231] The problems with group support were evident to the directors. It seems to me the email exchanges between Dame Jenny and Messrs Yan and Walker beginning in February 2010, and leading to the exchange of 12 and 26 August 2010, are important. Dame Jenny sought, but never received, an adequate resolution of the concern that the

directors of Mainzeal were required to be responsible for the company's solvency, and the position of creditors. Indeed, notwithstanding her concerns, it would appear that in August Richina Pacific was again seeking to extract yet further capital out of Mainzeal by withdrawing further funds. Given the insolvent state of the company, and its trading position, this can fairly be described as an extraordinary stance. Dame Jenny again expressed the view that the request to borrow further funds should not be acted upon until the procedures that were operating between Mainzeal/the New Zealand division and Richina Pacific/the Chinese division were more fully outlined and agreed. Mr Tilby added the comment in agreement that he was uncomfortable as an independent director because of the "overly flexible situation".

[232] Mr Yan's response to Dame Jenny's concerns can fairly be described as dismissive. He said that "nothing had changed" with the arrangements. But clearly it had. He stated that Mainzeal was operating under a shareholder/parent guarantee. But this was not the case. The only formal expression of this from the shareholders came in the form of the annual audit letter of comfort. There was no other "guarantee" in existence. Furthermore, the shareholders were not "on the hook for everything". Mr Walker's email of 26 August 2010 made the position even clearer. In it, he advised that Richina Pacific wanted to continue to extract funds out of Mainzeal when it wished, up to a maximum of USD 3 million per annum. But it provided no enforceable promises of repayment from the Richina Pacific group, and even said it was for the directors of Mainzeal to make decisions on whether Mainzeal was a going concern, and was solvent.

[233] In my view, the circumstances necessitated that the directors insist upon the arrangements changing so that Mainzeal was no longer required to continue operating in the manner I have described. I accept that they had a reasonable period of time to force the issue from the beginning of 2010 before they should be held to have agreed to, or allowed, Mainzeal's business to be conducted in this manner. But the simple point is Mainzeal could not legitimately be allowed to continue operating as it was.

[234] The severity of the situation was also identified in the email exchange between Mr Pearce and Mr Walker in connection with the October and November 2010 board meetings. Mr Pearce identified that there was a material risk that the directors could

resign given the lack of transparency and Mr Yan's responses, and he said that he found the situation "frightening". He referred to Mr Yan committing to transactions when the cash involved was from cash turnover and not any profit of the business. His emails were effectively raising the risk of failure of the company. Mr Pearce was raising the very issues that the directors themselves should have been raising. But it is the directors who needed to force the issue. As Mr Burt said, the "White Paper" produced by Mr Pearce and Mr Gomm very clearly identified the issues for the directors. It was placed before the board for the board meeting on 19 November 2010. That paper included a summary of the effect of ss 135 and 136 of the Act. It was a very clear further warning to the directors. But no meaningful discussion appears to have arisen at the board meeting concerning this matter.

Conclusion on group support

[235] The above factors lead me to conclude that the reliance on shareholder support was not reasonable in the circumstances. Shareholder support was important to the findings of the Court that no s 135 breach arose in *Jordan v O'Sullivan*[48] and *Delegat v Norman*[49]. It was not regarded as sufficient to avoid s 135 liability in *Re South Pacific Shipping Ltd (in liq)*.[50] In the cases where it has been relevant to a finding that the directors did not breach their duties, the companies were closely held, and the directors were themselves shareholders. In *Delegat v Norman*, the director was essentially risking his own capital as the secured creditor.

[236] That is not the situation in the present case where the directors were relying on more remote shareholder support. Even in Mr Yan's case, there were other ultimate shareholders of Richina Pacific who had different interests. The suggested shareholder support here was more remote, ambiguous, conditional, and subject to the constraints of Chinese law. This is demonstrated by what ultimately happened, as the support was not provided by Richina Pacific/CHC in 2013, leading to Mainzeal's liquidation. The support proved to be unreliable.

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48 *Jordan v O'Sullivan*, above n 21.
49 *Delegat v Norman* [2012] NZHC 2358.
50 *Re South Pacific Shipping Ltd (in liq)*, above n 13.

[237] I accept, however, that the above factors (the policy of trading while insolvent and the lack of reliable group support) may not by themselves lead to the conclusion that s 135 was breached. That is because of the possibility that Mainzeal's trading position was sufficiently strong to not need the assurance of a capital base, or the equivalent of such a base.

Financial trading position

[238] As indicated above, liability under s 135 only arises when there is a substantial risk of serious loss to the creditors. There may have been no substantial risk of failure if the company's trading performance was particularly good and dependable. But several features of Mainzeal's the trading position demonstrate that its performance was unpredictable and generally very poor. There are a number of factors relevant to this.

Trading position

[239] First, the company's trading position had been weak. That is particularly so when the revenue it was earning from the intercompany loans to the Richina Pacific entities is excluded. The financial accounts record interest income into the company's accounts for each year. But just as the loans themselves were not recoverable, because the entities were in no position to repay them, the interest income was effectively notional.

[240] If the intercompany loan income is excluded, the trading position of the company throughout was poor. This is demonstrated by the following table from Mr Apps's evidence. The middle line in this table — the earnings before interest and tax (EBIT) — provides the best guidance as it excludes the interest from the intercompany loans and other confounding aspects.

Table 3 – Financial performance

Year ended 31 December	2005 Stats[36]	2006 Stats[37]	2007 Stats[38]	2008 Stats[39]	2009 Stats[40]	2010 Stats[41]	2011 Stats[42]	2012 Mgmt Accs[43]
All $ amounts in $'000's								
Revenue from Construction Contracts	**432,244**	**451,928**	**288,656**	**269,993**	**378,823**	**340,742**	**382,080**	**333,292**
Cost of Sales	(428,485)	(431,142)	(269,284)	(256,428)	(363,055)	(321,200)	(364,605)	(321,654)
Gross Profit	**3,760**	**20,786**	**19,372**	**13,564**	**15,768**	**19,542**	**17,475**	**8,639**
Gross margin	*0.9%*	*4.6%*	*6.7%*	*5.0%*	*4.2%*	*5.7%*	*4.6%*	*3.5%*
Other Income	212	-	-	3,652	220	-	1,257	-
Forgiveness of debt	-	37,290	-	-	-	-	-	-
Investment write-off	-	(30,000)	-	-	-	-	-	-
PPP Bid Costs	-	-	-	-	-	-	(4,440)	-
Legal expenses	-	-	-	-	-	(3,717)	(5,063)	-
Undisclosed expenses [note 1]	(799)	-	-	-	-	-	-	-
General and administrative expenses	(16,115)	(15,912)	(16,847)	(19,622)	(15,135)	(16,846)	(19,356)	(21,841)
Operating Profit (at the level of EBIT)	**(12,143)**	**12,164**	**2,525**	**(2,406)**	**854**	**(1,021)**	**(10,126)**	**(13,202)**
Finance income	5,411	2,688	3,026	3,498	3,406	2,799	3,077	375
Finance costs	(1)	(56)	(488)	(276)	(976)	(20)	(111)	(349)
Finance income – net	**5,411**	**2,632**	**2,539**	**3,222**	**2,431**	**2,779**	**2,966**	**26**
Profit before income tax	**(7,533)**	**14,795**	**5,063**	**816**	**3,284**	**1,758**	**(7,161)**	**(13,176)**
Income tax (expense)/credit	-	-	6,045	(6,045)	-	-	-	-
(Loss)/Profit for the year	**(7,533)**	**14,795**	**11,108**	**(5,229)**	**3,284**	**1,758**	**(7,161)**	**(13,176)**

Note 1: The 2005 comparative figures in the 2006 financial statements do not appear to add correctly. I have assumed that this is because of undisclosed expenses of $799,000

[241] In 2005, there had been a very significant operating loss of $12.1 million. But this was followed by a healthy profit for 2006 — albeit that year had been influenced by the one-off capital profit on the Mobil on the Park development. There was a much-reduced operating profit the following year. That was followed by a year where it made another loss, then a very modest profit, and then another loss. Furthermore, these results demonstrate that the financial results could not be predicted with any degree of certainty. Taking the financial results through to the end of the 2010 year — the critical moment on the plaintiffs' case — the results had been highly variable.

[242] I accept that the directors had some basis to hope for improvement in early 2011. A number of potentially profitable lines of business were being explored and

key contracts had been won. There was an expectation that the Canterbury earthquakes would generate significant construction work. A joint venture was formed to carry out repairs for Vero claims, and Richina Pacific had made arrangements to obtain funding by way of assistance from the China Development Bank. The forecasts at the time were optimistic.

[243] But optimism had existed at previous times as well, and construction was a difficult business. It was well known that the industry operated on very small margins. It was also noted that there had been a consistent failure of the company to meet its budgets. Mr Apps's evidence demonstrated that the company had failed to meet its budgeted EBIT in every year between 2006 and 2012. In the 2007 and 2008 years, the budgets were missed by significant amounts — $4.8 million and $5.6 million. In 2009 and 2010, it was not as dramatic but still very significant, with the budgets being missed by $1.23 million and $2.4 million. In the minutes of a meeting of RGREL in December 2008, at which all regional managers of Mainzeal were present, Dame Jenny is recorded as saying "the biggest concern remained the history of failure to achieve turnover forecasts combined with the potential slow in spend by clients". The corporate governance experts also agreed that Mainzeal's management reporting was generally inadequate.

Prospects of one-off losses

[244] Secondly, the nature of the construction business of the kind Mainzeal was engaged in involved a significant risk of large one-off losses. Such a company may have something in the order of 25 construction contracts on-foot in any one year, and a risk arises that one or more of those contracts may suffer a significant problem. When such a problem arises, it can create significant financial pressure. It was precisely one such contract — the Siemens contract — that led to the problems in late 2012, which significantly contributed to Mainzeal's collapse. As Sir Paul said, when he joined the board it was business as usual, but the problems on this contract "knocked all that for six".

[245] But such six hitting was entirely predictable. The evidence demonstrated that Mainzeal was liable to suffer significant one-off losses associated with particular

projects. Indeed, this is Mr Yan's own evidence with respect to the Vector Arena and Scene Apartments developments. He said that the construction business was "more volatile" than Richina Pacific's other lines of business and that:

> 52. As I have explained, the late 2005 to 2008 period was extremely difficult for Mainzeal. The only reason Mainzeal survived this period was due to Richina China group support. …
>
> …
>
> 60. Throughout the 2005 to 2008 period, the process of supporting Mainzeal was just as difficult as it was in 2012, but against all odds, Richina succeeded in rescuing Mainzeal.

[246] As I have already explained, the evidence does not support Mr Yan's claim that significant financial resources were put into Mainzeal to rescue it in the earlier years. But the key point is that the previous history of the company had given rise to the potential need for rescue. In cross-examination, Dame Jenny explained that the construction industry was difficult to predict, and this period was also influenced by the global financial crisis. She was asked:

> Q. Right, and indeed, you were having a very busy year in 2012, yes? Siemens, other problems.
>
> A. Well, Siemens was the dominant issue by far. You can't have a cashflow deteriorate by $20 million without it becoming a serious problem.
>
> Q. And you'd had a serious problem with Arena, years before?
>
> A. We discussed that two days ago, and it was a significant loss.
>
> Q. And would you agree that these sort of problems are not necessarily inevitable, but quite likely to arise from time to time?
>
> A. In construction companies?
>
> Q. Yes.
>
> A. Oh, I think Mainzeal and Hawkins, and others, and Fletcher's, bear witness to that.
>
> Q. Yes, and so you need either a very healthy balance sheet or, if I could say, on your view, access to parent capital, when required.
>
> A. We had a strong parent.
>
> Q. And you need immediate access to that parent capital when required.

> A. We saw the prepaid goods as a very strong vehicle. We at no stage during 2012 could not pay our bills as they fell due, in my recollection, other than two accounts, which were discussed and agreed that they would go longer than the normal billing cycle. We were up to date with tax. I don't agree with you, your conclusion that we were in a precarious position. Siemens was a huge challenge.

[247] As indicated above, the Pre-Paid Goods Agreement could only ever extract value over time. It was a compromise arrangement arising from the restrictions on getting money out of China. Ultimately it did not deliver good value, with the losses incurred on the associated projects being roughly equivalent to the value of the goods supplied, and it was unenforceable.

[248] Sir Paul also accepted the emergence of cash flow issues arising from particular contracts was a recognised feature of the industry. He had knowledge of this himself, as Brierley Investments Ltd, the group with which he is historically associated as Chief Executive Officer, had owned Downer Group. This feature was also referred to by other witnesses, and I accept that this is so. The Siemens issues in 2012 were predictable at a general level. The industry had a degree of volatility about it. This was illustrated by the company's financial results in the 2005 and 2006 years. Mainzeal was vulnerable to such financial results reoccurring. That is exactly what occurred. Excluding the intercompany interest income, there was a loss in the 2011 year of $10.1 million, and a loss in the 2012 year of $13.2 million (as recorded in the unaudited management accounts), leading to the collapse in early 2013. The company had suffered just such a loss in 2005 of $12.1 million.

Leaky building liabilities

[249] Thirdly, by 2010 there was a growing problem with significant leaky building claims against Mainzeal. I accept the evidence presented by the plaintiffs that it became increasingly apparent that there was a significant systemic leaky buildings problem in New Zealand, and considerable liability arising for those that had been involved in constructing buildings of a particular type. Mainzeal had been involved in such projects as the main construction party. By 2010, a series of very significant claims had been made against Mainzeal in relation to its past construction contracts.

[250] Mainzeal's approach to provisioning for such liabilities involved it only making provision for the expected cash demands for each claim in that financial year, for example legal costs, with no provision made for any ultimate liability. In his evidence, Mr Apps put in a table comparing the provisions made in Mainzeal's accounts, with the liabilities under the leaky building claims as they were subsequently recognised (recorded in the year the claims were first notified). This suggested a very substantial under-provisioning, albeit with the considerable advantage of hindsight. Mr Hodder provided a revised version of that table which replaced the ultimate liability figure with figures that had been advised to the board at the time. The revised table shows both sets of figures as follows:

WEATHERTIGHTNESS LIABILITY AS ADVISED TO THE BOARD

Apps 1 - Table 20
Liability advised to the board~~Notified costs~~

All amounts in $'000	**2009**	**2010**	**2011**	**2012**
Hobson Gardens[1]	16,000	16,000	~~8,720~~7,000	~~8,720~~7,000
Fern Gardens[2]	7,000	7,000	2,500	2,500
Argent Hall[3]	~~12,420~~-	~~12,420~~-	~~12,420~~5,000	~~12,420~~5,000
Total pre-2010 notified claims	**~~35,420~~23,000**	**~~35,420~~23,000**	**~~23,640~~14,500**	**~~23,640~~14,500**
Botany Town centre[4]	-	-	~~46,000~~-	~~46,000~~18,000
Bay Point Apartments[5]	-	~~3,375~~200	~~3,375~~400	~~3,375~~3,000
Braemar Villas[6]	-	~~2,600~~-	~~2,600~~650	~~2,600~~650
Anchorage Apartments[7]	-	-	5,000	5,000
Summerfield Villas[8]	-	-	~~12,000~~-	~~12,000~~600
The Lofts[9]	-	-	~~10,000~~-	~~10,000~~3,750
Notified costs	**~~35,420~~23,000**	**~~40,395~~23,200**	**~~102,615~~20,550**	**~~102,615~~45,500**
Provisions contained in financial statements at year end[10]	**3,000**	**3,510**	**12,560**	**21,809**

[251] Even these revised figures show a very significant potential under-provisioning. In the 2009 year, there was $3 million provisioned in relation to claims advised to the board to amount to $23 million, and in 2010 a provision of $3.51 million was made for claims notified with values of $23.2 million.

[252] Mainzeal, particularly at the instigation of Mr Gomm, employed a strategy of resolving leaky building claims by a particular process. First, Mainzeal would estimate what it would cost to conduct an effective repair of the leaky building whilst at the same time excluding the "betterment" inherent in the new building standard

requirements imposed by councils.[51] Then, Mainzeal would obtain a building consent to conduct the repair to that standard. It would present that proposal in settlement discussions, and attempt also to do the repair itself. This approach minimised the potential costs involved in the leaky building claims.

[253] I accept that this was an effective strategy to deal with leaky building claims. Significantly, the auditors accepted this approach to provisioning. Mainzeal also managed the issue in conjunction with external legal advisers. I also accept that there can be no criticism of the provisioning in the accounts by itself, particularly as the auditors accepted that this mode of provisioning was reasonable, and complied with the standards. But there was a risk associated with this approach. If any particular leaky building claim was not effectively managed by this process, then it was possible that a very significant financial liability could emerge. Moreover, there was always the risk of further claims being advanced on other historic projects. This was a further latent problem that could have itself triggered the collapse of a company while it was trading in such a vulnerable state.

Changed business plans

[254] Finally, it had become apparent by 2010 that Mainzeal's business model was not working. The defendants emphasise that, during 2010 in particular, considerable effort was made to transform the business strategy. The idea was to get better value out of its beneficial Chinese supply arrangements, and move away from residential buildings into public/private partnerships, including civil infrastructure projects such as the Siemens contract. During 2010, management worked with the board, and with Ernst & Young, in formulating a revised business strategy along these lines. Richina Pacific itself wanted Mainzeal to move away from pure construction and develop property development and financial services businesses.

[255] Such steps are not in themselves problematic. But, by its very nature, the new approach involved a recognition that Mainzeal's existing business strategy was not working. Given that Mainzeal was balance sheet insolvent, to put significant faith in

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[51] This was on the basis that the claimant could only require Mainzeal to put the building in the situation it would have been in under the building standards at the time.

a change of business strategy on the assumption that this would revolutionise Mainzeal's generally poor performance involved significant risk.

[256] The evidence demonstrates that these risks came to fruition. The risk associated with the Pre-Paid Goods Agreement, and the supply from King Façade, became a very significant problem in 2012, with Mr Gomm's report to the board for October 2012 assessing the loss arising from the problems of supply and other matters at $6 million. That is at approximately the same level as the value of the goods supplied under the Pre-Paid Goods Agreement for Mainzeal's benefit. Moreover, the financial records also demonstrate that Mainzeal expended considerable amounts on attempting to tender for Government-related projects, being the new kind of work that it was focusing on in the revised business strategy. Those attempts were largely unsuccessful, and expensive.

[257] Changing business strategy — engaging in business risk — is the sort of thing that companies are supposed to do. That is the very purpose of limited liability. There can be no objection to company directors agreeing to take such steps and taking on the risks that go with it. But here the change in direction at this stage emphasised that Mainzeal did not have a reliable trading position. The changes also increased the likelihood of one-off losses occurring in the short-term given the risks associated with new types of activities, which only further deteriorated Mainzeal's ability to rely on its financial trading position to avoid a complete failure of the company.

Conclusion on financial trading position

[258] The above factors, in combination with the fact Mainzeal was trading while insolvent without reliable group support, meant that Mainzeal's trading position made it vulnerable to failure with consequential substantial loss to the creditors.

Additional Factors

[259] The combination of the above three factors, as summarised at [187] above, is the key reason why I have found that the directors breached their duties under s 135. But it is necessary to address several additional matters raised in argument that are relevant to these factors, or which are said to demonstrate that s 135 was not breached.

Reliance on auditors

[260] Firstly, the defendants emphasised that they had relied on the auditors, Ernst & Young, in making their assessments in relation to Mainzeal's position. I accept that some comfort could be taken from the auditors' views, and that this is the kind of reliance that s 138 of the Act contemplates. The auditors confirmed that Mainzeal was a going concern when they signed off the annual accounts. Dame Jenny explained in her evidence that the directors met separately with the auditors each year for this purpose. There was also evidence that the auditors had taken steps to check the reliability of group support, even to the point of going to China to physically see the assets that backed up the group. Given the apparent thoroughness of that process, I accept that some comfort could be taken.

[261] But there are limits to what the directors could reasonably take from Ernst & Young's views. First, the actual auditing standard the auditors applied did not involve a particularly high threshold. ISA (NZ) 570 Going Concern provides:

> **Going Concern Assumption**
>
> 2. Under the going concern assumption, an entity is viewed as continuing in business for the foreseeable future. General purpose financial statements are prepared on a going concern basis, unless those charged with governance either intend to liquidate the entity or to cease operations, or have no realistic alternative but to do so. …

[262] Mr Schubert gave evidence that this standard involved a low hurdle — Mainzeal was a going concern unless it had "no realistic alternative" but to cease trading. I accept his view, whilst also recognising the view of Professor van Zijl that auditors will scrutinise these issues carefully, so that in substance the bar may be seen as higher than the literal wording suggests.

[263] However, even the acceptance that this hurdle had been cleared was subject to the "emphasis of matter" paragraph in the auditor's letters. This is required under paragraph 18 of the ISA if there is a "material uncertainty" about the going concern assumption. Whilst this is short of saying the accounts were qualified, the "emphasis of matter" meant that the approval of the auditors did not provide significant comfort on the key issue the directors needed to confront. In fact, it raised a question of

possible concern about Mainzeal even continuing to operate for the next 12 months. As Professor van Zijl also said, the wording of the "emphasis of matter" stated that the very validity of the going concern assumption depended on the financial support — that is, without it, the going concern assumption was not valid. Accordingly, this emphasised (literally) the importance of support for the directors' responsibilities. So the auditor's opinion begged the critical question.

[264] I also observe that I did not hear from the auditors themselves. It is somewhat unusual to receive expert opinion evidence from Professor van Zijl and Mr Schubert as to what Ernst & Young's opinions meant, and what reasonable conclusions could be drawn from them. And whilst the directors referred to their verbal exchanges with Ernst & Young representatives, and to Ernst & Young's visit to China, the evidence in this respect was of a somewhat general nature, and did not have the particularity that might have been expected from the auditors themselves had they given evidence.

No legal advice taken

[265] Secondly, the plaintiffs relied on the fact that the directors did not take external advice, particularly external legal advice, on their responsibilities notwithstanding that a number of important issues had emerged. The obtaining of advice may have significance given s 138 of the Act, which allows directors to rely on advice provided to them, including professional advice. That provision applies to other advice received by the directors, including from the employees, auditors, and advisors to Richina Pacific and the group. The circumstances here suggest that external legal advice was warranted, and it was not sufficient to rely solely on Richina Pacific's advisors.

[266] A number of legal issues had emerged. In her February 2010 email, Dame Jenny asked who had responsibility for decisions concerning solvency following the restructuring. That was really a legal question, and it was an important question to ask. Mr Yan, in his email of 12 August 2010, then made a number of assertions that were highly questionable from a legal perspective — such as that Mainzeal was operating under a parent guarantee with the shareholders "on the hook for everything", and that Mainzeal was not an independent company as such. It was these very kinds

of assurances on which the directors appear to have placed reliance. But these propositions raised significant legal issues.

[267] Moreover, there was the more general point about the reasonableness of reliance on promises of support, and whether the letters of comfort written in association with the annual audit were legally enforceable. Following the restructuring, there was also the question about the new arrangements, whether s 131(2) still applied under those arrangements, and whether the terms of the original Charter and accompanying letter remained appropriate. All of these significant legal questions were not the subject of any formal legal advice, let alone external legal advice. The "White Paper" prepared by Messrs Gomm and Pearce identified some of the issues, including the relevance of s 135, but it was correctly identified as only providing a starting point, and it had been prepared by non-lawyers.

[268] The board ultimately took formal legal advice on the issue for the first time on 4 December 2012, after Sir Paul suggested it. This was the month before the collapse. The advice was that the directors needed to ensure that the commitments from Richina Pacific on which the board was relying were documented in a legally binding way. That advice was sound. Mr Hodder argued that this advice was provided in the context of the issues confronting the company at that time. A threat of collapse was a real prospect. But in my view the legal advice was equally applicable to Mainzeal at earlier stages.

[269] Mr Hodder also contended that it would be inappropriate for the Court's findings to overly emphasise the need to take legal advice in order for directors to perform their duties, as this involved what he called "defensive legalistic protection in business". I do not accept this. Legal advice was of importance in the present case because of the exceptional circumstances. A series of very important legal issues had emerged. They were of central importance to a key issue facing the company and concerning the directors' duties — namely the question of solvency, and responsibility for trading in an insolvent state. The failure by the directors to seek any external advice related to their duties at all until the very end reflects their failure to comply with their duties.

Corporate governance standards

[270] Thirdly, as indicated, the plaintiffs relied on an allegation of poor corporate governance standards. It can be relevant to consider corporate governance standards, including for the purpose of considering whether the directors were engaged in taking legitimate business risks. Expert evidence was called by both the plaintiffs and the defendants in relation to such corporate governance issues. The plaintiffs called Messrs Maier and Burt, and the defendants called Mr Westlake. All are very experienced company directors with considerable corporate governance experience. I also had the advantage of a joint report from them after they conferred. They generally advised the Court on what can be regarded as good corporate governance standards, which is of assistance in assessing the questions arising under s 135.

[271] They were all critical of Mainzeal's corporate governance arrangements.[52] The directors had no formal procedures for addressing risk. There was no audit and risk committee, and the board was too small to have one. Neither was there any formal risk register. These issues were highlighted by Ernst & Young in its January 2011 report. By itself, that would not matter if risks were otherwise appropriately addressed. But I accept the evidence of Messrs Maier and Burt that they were not.

[272] I also accept the evidence of Mr Maier that the directors' attention was too operationally focused. The discussion at the board meetings was focused on how Mainzeal's business operations were progressing — with reference to contracts being won and lost, how they were performing, the consequential cash flow and profit forecasts, and other matters of this nature. Such operational issues dominated the discussions. The more significant structural and governance risks were not given the same attention. The board operated more as a management committee, and failed to properly address the governance issues and the systemic risks to the overall operation. The directors accordingly failed to give proper attention to the manner in which the controlling interests of the Richina Pacific group were organising Mainzeal as an overall business enterprise.

[52] A main difference with Mr Westlake is that he was of the view that the directors did not make an unreasonable decision by trading on.

[273] Nevertheless, it is not my function to engage in a general critique of how well the directors performed their functions. The duty in s 135 is a far more focussed question. So the more general criticisms of the directors are not of primary significance in relation to the findings on the breach of s 135.

Creditor knowledge

[274] The final factor raised by the plaintiffs that I take into account relates to the knowledge that the creditors would have had. This can be relevant to the assessment under s 135.[53] As indicated above, s 135 is not concerned with the normal business risks companies are established to take, and some risk to creditors is inherent within a company's normal business risks. Considering whether the risk to creditors is of the normal kind can involve an assessment of the risks that the creditors are aware of — in other words, this factor helps identify the normal trading risks. It is only when the manner in which the company undertakes business moves beyond those risks and into the area of abnormal or extraordinary risks — the substantial risk of serious loss to creditors referred to in the section — that s 135 is engaged.

[275] The creditors would not have had understood Mainzeal's vulnerable state, and accordingly the substantial risks involved. From the creditors' perspective, Mainzeal was paying all its bills on time, and it was backed up by the apparently wealthy Richina Pacific group. The evidence was that Mainzeal's accounts were not freely available, but were presented as part of tendering for construction works, so were likely known to the contractual principals and the bondsman. They were a substantial category of creditors in the insolvency. The accounts may also have been accessed by other creditors, such as sub-contractors and other traders. Regardless, the accounts would not have demonstrated the vulnerable position. Mainzeal would have appeared to be solvent. There was no reference in the accounts to the intercompany receivables not being repayable — that was not identified by the "emphasis of matter" note provided by the auditors. More broadly, a number of steps had been taken to make the accounts look better — including the steps described in Mainzeal's internal documents as being for "window dressing" purposes. This included the restoration of the intercompany balances at mid-year and year-end dates. Other such steps were taken in relation to

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53 See *Re South Pacific Shipping Ltd (in liq)*, above n 13, at [150](4).

Mainzeal's immediate holding company, RGREL, through the recording of the Kunshan Richina Hotel Co share transfer, and the recording in RGREL's accounts of the redeemable preference shares as capital that could be called upon. These steps all exaggerated the financial strength of Mainzeal.

[276] The creditors would also have generally understood that Richina Pacific stood behind Mainzeal. They would not have understood the extent to which Richina Pacific had limited its ultimate liability, including in relation to the intercompany receivables. Richina Pacific's real exposure was limited to the construction bonds, and those would only arise if Mainzeal failed. From the creditors' perspective, failure would have been seen as a low risk. This was a well-established company, chaired by a former New Zealand Prime Minister. It was not a new company in start-up mode. These are relevant considerations in identifying the dividing line between the risk to creditors subsumed within the normal trading risks of a company, and the substantial risk of serious loss to the creditors with which s 135 is concerned.

Conclusion

[277] For all the above reasons, I have found that s 135 was breached. The three key considerations are those summarised at [187]. The plaintiffs have met the high hurdle required to establish breach, cumulatively because Mainzeal was trading while balance sheet insolvent, with a long history of poor trading performance and exposure to significant one-off losses, and without a binding or reliable assurance of group support.

[278] The point is illustrated by some of the matters that were major contributors to the company's failure. All the directors referred to the impact of the Siemens dispute. But Mainzeal should not have failed simply because a major contractual party withheld payments, even significant ones. Such cash flow issues were a common risk. Indeed, the Siemens contract ended up being a profitable one even though Mainzeal was paid far less than it claimed. The crisis caused by the cash flow delays was the product of the compromised state the company was in. A further example is the losses on the King Façade arrangements, estimated to be $6 million in internal

documentation, which were connected to the Pre-Paid Goods Agreement, the entry of which arose from the position that the Richina Pacific group had adopted.

[279] Only one factor has caused me to hesitate in finding s 135 was breached —that Richina Pacific's contingent liability under the construction bonds gave it a strong incentive to prevent Mainzeal's failure. But in the end this incentive provided inadequate protection. Its reliability depended on Richina Pacific's financial interests, whether it thought it was in a better or worse position by providing further funding, and the limits of its ability to do so. The limits on what it was willing and able to provide were reached in late 2012/early 2013. That there was a substantial risk of serious loss to creditors notwithstanding this incentive is further demonstrated by the $110 million loss that did eventuate. This was precisely the risk of loss that existed.

[280] Richina Pacific had required Mainzeal to adopt a policy of insolvent trading whist using the creditors' funds as working capital, and did so continuously over a number of years as part of its modus operandi. The expressions of support from Richina Pacific were not provided in a clear, enforceable or reliable way sufficient to allow an enterprise of this size to trade in this manner. It was a mere assumption of support. This was unjustifiable. This is particularly so given the size of the losses that would be caused by failure. Mainzeal was not a strongly performing company — it was liable to losses, including very serious one-off losses, and its business was not settled. Its continuation was ultimately a matter of the Richina Pacific group's choice. It was these risks that came to fruition when support was withdrawn, causing Mainzeal to fail with substantial creditor loss.

[281] Mr Hodder argued that there should be no liability under s 135 unless the insolvency of the company is imminent or unavoidable. That was at the heart of his argument that the section only applies to circumstances where directors should cease trading, but continue to trade, creating further loss to creditors. I do not accept that this is so. That situation is the usual reckless trading scenario, but it is not the only situation contemplated by s 135. Indeed, the wording of s 135 suggests the opposite, as the "manner" in which the business of the company is being "carried on" more naturally applies to the way the business is being conducted on an on-going basis rather than the decision whether to trade at all. There can be a substantial risk of

serious loss to creditors arising from trading a substantial company in a manner where it is vulnerable to collapse with a serious deficiency on liquidation. That is exactly the risk that eventuated. In terms of the apparent policy of the provision, this is just as unjustified as causing loss by trading on companies destined to fail. Both involve illegitimate harm to the creditors. In the end, it is a matter of applying the words of the provision in light of their purpose. Section 135 is not limited to liability arising from continuing to trade a company that is hopelessly insolvent in a cash flow sense. It can apply to other situations.

[282] For similar reasons, I reject Messrs Chisholm and Hodder's arguments based on Mr Graham's evidence that Mainzeal had none of the characteristics of a company that was trading in breach of s 135 — in particular, because it did not have significant and growing overdue creditors shortly before it collapsed. Whilst Mainzeal did not have that feature, it was nevertheless trading while insolvent. Because of the cash flow advantages in the construction industry, it was doing so using creditors money as working capital, which disguised the problem.

[283] Mr Hodder also argued that the present case is distinguishable from the normal reckless trading case because there is no issue of the directors having significant conflicts of interest. While I accept that is so with respect to his clients, Mr Yan had a clear conflict of interest. He was both the person from whom the directors were seeking support, and the person effectively providing it. He owned a significant percentage of Richina Pacific personally. In his capacity as a director of Richina Pacific, he also had obligations to that company, and, by extension, was constrained by the interests of its other shareholders. It would not have been in their best interests (or his) for Richina Pacific, or the broader group, to provide a legally binding obligation of support to Mainzeal if that could have been avoided.

[284] It is appropriate when assessing all of the above considerations to be clear s 135 is not concerned with the normal business risks that companies exist to take. It is only when illegitimate risk taking to the standards contemplated by this section are involved that a breach arises. Here I am satisfied that the risks taken by the directors cannot be regarded as normal business risk taking. On the contrary, the directors allowed Mainzeal to continue to trade in highly unorthodox circumstances, which involved a

very significant risk to the creditors. The directors here were not taking the normal risks that are inherent in the operation of a company of Mainzeal's size.

[285] Mr Hodder argued that a finding that the directors were liable in the circumstances of this case would create a disincentive for people to accept directorships of major companies. I do not accept that. The circumstances of the present case are highly unusual. The directors were being asked to undertake the business of the company when it was insolvent. There were a number of very significant factors, and warnings, that suggested the directors should not do so. This is not a case where I have found the directors liable because of the way they have dealt with normal issues that company directors face. The circumstances of this case can fairly be described as exceptional.

[286] A finding that the directors had not breached their duty under s 135 in these circumstances would have the opposite adverse implications. It would undermine the purposes of s 135. It would also suggest that directors of companies within corporate groups do not need to consider the types of risks that would normally be very serious for a stand-alone company. That is simply not the case. How the group dynamic impacts on the performance of directors' duties will depend on the circumstances. Here, the circumstances were such that the directors breached their duties.

[287] Ultimately, Mr Hodder's submission does not assist me in applying the standards set by s 135. It is those standards that must be applied, and which result in the finding that the directors breached their duties. Neither does a finding of liability involve questioning legitimate business judgment, or expecting clairvoyance from the directors, as Mr Hodder submitted. The factors that give rise to breach are well outside the latitude allowed for business assessments made by directors, and were squarely raised for the directors at the time.

The timing of the breach

[288] Liability for reckless trading arises when a director agrees to the company carrying on business in the infringing matter (s 135(a)) or alternatively when the director causes or allows the company to conduct business in that manner (s 135(b)). These requirements are to be assessed objectively, and they do not include any

subjective element.[54] But the concepts of causing, agreeing and allowing suggest a decision by the director to conduct business in the infringing way, or at least the acceptance of this manner of conducting business. But this must be ascertained objectively.

[289] In the present case, the infringing manner in which the company engaged in trade was initiated by the shareholder group. To demonstrate a breach by the directors it is necessary to ascertain when the directors caused, agreed or allowed Mainzeal to conduct trade in the infringing manner. I have focussed on the events following the restructuring in 2008/09. Whilst arguments could be made that the directors breached their duties even prior to that time, the restructuring significantly affected the reasonableness of the reliance the directors could place on group support. It is also the time period focused on by the plaintiffs.

[290] The shareholder group's decision that Mainzeal should conduct business in this infringing manner following restructure seems to have been confirmed by the Richina Pacific audit committee on 26 May 2009. But I do not think the directors of Mainzeal should be held to have caused, agreed or allowed Mainzeal to conduct business on this basis before the effects of the restructuring and the nature of ongoing group support were finalised. I also accept that the directors should not be held to have agreed to, or allowed, the infringing trading immediately after the restructuring, which they were more fully informed of at the December 2009 board meeting. Through Dame Jenny, they had raised significant issues concerning the manner in which the business was to be conducted following the restructuring. This was raised expressly in February 2010 in a manner suggesting that they were not so agreeing or allowing, let alone causing this manner of trade. I do not think they should be taken to have agreed or allowed the business to be conducted on that basis at this stage, even construing the matter objectively.

[291] But, in the end, they did so during the following months. At the very least the directors allowed the company to conduct trade on the infringing basis by mid-2010. The later email exchanges in August 2010, which were discussed at the 26 August

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54 *Mason v Lewis*, above n 11, at [53]–[56].

2010 board meeting, led ultimately to the Mainzeal board meeting on 13 October 2010. It was at that board meeting that Mr Yan advised that nothing had changed, echoing his earlier email. After that meeting, Dame Jenny emailed Mr Walker to say that the matter needed attention, and Mr Walker supplied the draft resolutions and letters of comfort (which did not include any from Richina Pacific/CHC). The next board meeting, on 19 November 2010, was perhaps the last occasion where the directors could reasonably have drawn a line in the sand. But nothing occurred of that kind, with the only decision at that time being that Mr Gomm would obtain advice from Ernst & Young on governance. In those circumstances, and given that the section is applied objectively, I conclude that the directors either agreed to, or allowed, the business of Mainzeal to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors from mid-2010. In the case of Mr Yan, it may be that he caused the infringing manner of trade prior to the other directors agreeing or allowing it given his role in establishing what the arrangements would be at an earlier stage.

[292] It is unnecessary to make a more precise finding on the time of the breach. All the directors continually breached their duties under s 135 from this period. The plaintiffs' pleadings contend that the breaches occurred from 31 January 2011, or alternatively 31 July 2011. I accept that breaches occurred at those dates.

[293] It is not a matter of saying that the directors of Mainzeal should have placed the company in voluntary liquidation. Ultimately, the fate of Mainzeal was really in the hands of Mr Yan and the Richina Pacific group. The matter required direct resolution, and Dame Jenny, Mr Tilby and Mr Gomm needed to make it clear that the company could not continue to trade unless the arrangements changed to address the policy of insolvent operation. The position was that, almost literally, Mr Yan had to put up, or shut up. If Mr Yan refused to do so, they could properly have taken the stance that they would resign, with the decisions to be taken by Mr Yan (and anybody else appointed as directors in their place). Such resignation had been seen as a prospect by Mr Pearce in October 2010. I accept Mr Burt's evidence that raising resignation unless matters were resolved was an appropriate stance for the directors to take — in effect, a tactic to put the company back into a proper position. Continuing

on as a director when there are serious issues can be highly detrimental to creditors.[55] Given the reputation of the directors, including Dame Jenny's status as a former Prime Minister, such resignations would have been very significant to Mainzeal's reputation and Richina Pacific's reputation. The threat of resignation was, accordingly, a very powerful tool.

SECTION 136 COMPANIES ACT 1993

[294] The plaintiffs also allege that the directors breached their duties under s 136 of the Companies Act. Section 136 provides:

> **136 Duty in relation to obligations**
>
> A director of a company must not agree to the company incurring an obligation unless the director believes at that time on reasonable grounds that the company will be able to perform the obligation when it is required to do so.

[295] In describing the requirements for liability under s 136, Clifford J held in *Jordan v O'Sullivan*:[56]

> [54] Turning to s 136, I note that there directors have a duty not to agree to the company incurring an obligation unless they believe on reasonable grounds that the company will be able to meet that obligation.
>
> [55] Section 136 therefore entails a mixed, objective-subjective approach. The director will breach the duty unless he or she subjectively believes, at the time the obligation was entered into, that the company will be able to meet the obligation incurred when it is required to do so. That subjective belief must, however, be based on objectively reasonable grounds (see, for example, *PC Company Ltd v Sanderson* HC HAM CP18/00 1 November 2001).
>
> [56] The need for the director's belief to be based on objectively reasonable grounds means the director must have sufficient knowledge of the company's position and ability to meet the obligation so as to give rise to reasonable grounds. It is implicit that the director must take sufficient steps to obtain this knowledge – claiming ignorance will not be a defence.

[296] In *Goatlands Ltd (in liq) v Borrell*, Lang J said:[57]

> [113] Like claims under s 135, claims under s 136 are often brought in circumstances where the directors of a company have permitted the company to incur liabilities to trade creditors at a time when the company is insolvent.

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55 See *Davidson v Registrar of Companies* [2011] 1 NZLR 542 (HC) at [133].
56 *Jordan v O'Sullivan*, above n 21, at [54]–[56].
57 *Goatlands Ltd (in liq) v Borrell*, above n 22, at [113].

> In principle, however, there is nothing to prevent the section being applied in relation to standalone, or "one off", transactions. The wording of the section is such, in fact, that it may be of particular utility where the directors of a company have permitted it to incur liability in relation to a single transaction in circumstances where they did not believe on reasonable grounds that it could meet that obligation.

[297] In my view s 136 involves a materially different question from s 135. The requirements of s 135 involve questions of risk taking to the standards prescribed by the section. Section 136 is not based on directors taking risks. It is based on the performance of specific obligations and the associated beliefs of the directors. To establish a breach of s 136, it must be established that, at the time the obligation was entered into, the director did not believe that the company would be able to meet its obligation; or, if it is established that the director did believe that the company would be able to meet its obligation, that his or her belief was not based on reasonable grounds.

[298] It is important that the objective component of the test in s 136 is directed to the grounds that the directors had for their belief. It focuses in on the grounds that the directors had for believing that the company would be able to meet its obligations as entered, and whether those grounds were reasonable. It does not involve a more general question whether the directors were acting reasonably, or were exposing creditors to unreasonable risk.[58]

[299] As Lang J recognised in *Goatlands Ltd (in liq) v Borrell*, the section applies as much to individual transactions as it does to the company's overall obligations. Indeed, particular obligations provide the focus for s 136. Section 136 "… focuses on a particular transaction rather than the general conduct of the company's business".[59] In a classic reckless trading case, where insolvency is imminent or unavoidable, s 136 may potentially apply to all the obligations the company enters into while continuing to trade. Outside of that type of situation, the section requires more careful consideration in relation to the specific obligations the company is entering. The test under s 136 is with respect to a specific obligation entered by the company — it is

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58 For recognition of this distinction in a different statutory context, see *Jefferies v R* [2013] NZCA 188 at [183], [186] and [189].

59 *Peace and Glory Society Ltd (in liq) v Samsa* [2009] NZCA 396, [2010] 2 NZLR 57 at [44]. See also *Grant v Johnston* [2016] NZCA 157 at [43].

transactional. In the present case, it requires focus on particular obligations under specific construction contracts that Mainzeal was entering. With respect to any such contracts considered by the directors, the question is whether they subjectively believed that Mainzeal would be able to meet the obligations under those contracts, which may have involved obligations over a reasonably significant period of time. If they did have that belief, a question arises whether the grounds they had for it were reasonable.

[300] There is reference in some of the authorities to s 136 being concerned with transactions on capital account rather than revenue account.[60] With respect, I do not see how, or why, that distinction is within the text or purpose of the provisions, or how it is helpful. The construction contracts entered by Mainzeal here would have been on revenue account, as most obligations entered by a company in trade will likely be. So, such a distinction seems to be a distraction. It was not supported by any submissions of counsel before me.

[301] Trying to identify with precision the area of overlap between the sections is otherwise a somewhat abstract exercise. The most important point is that the sections have different requirements, and involve different tests, which may or may not involve overlap in any particular case.

DID THE DIRECTORS BREACH THEIR DUTIES UNDER S 136?

[302] The plaintiffs claim related to breach of s 136 was advanced as the first cause of action. The plaintiffs seek orders requiring the directors to contribute between $69.427 and $75.348 million, adopting the "new debt" calculation of loss, addressed in greater detail below.

[303] Whilst I have found that the directors breached their duties under s 135, that does not necessarily mean the directors have breached their duties under s 136. The distinct requirements of the duty in s 136 need to be applied. The plaintiffs' third amended statement of claim, dated 12 July 2018, did not identify specific obligations

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60 *Peace and Glory Society Ltd (in liq) v Samsa*, above n 59, at [44]; *Grant v Johnston* [2015] NZHC 611 at [134]; and *Grant v Johnston*, above n 59, at [43].

as part of this claim. It alleged, more broadly, that by a certain stage continuing to incur new obligations involved a breach. It is not entirely clear from what date this is alleged, but it can be inferred that the allegation is that from January 2011, or alternatively July 2011, any new obligations involved a breach. It appears to be an allegation in relation to all obligations entered by the company from that time. It is the type of allegation that is consistent with the type of case where the directors were continuing to trade a company when liquidating was unavoidable, by entering obligations that could not be met.

[304] Unsurprisingly, given the content of the amended statement of claim, the directors' briefs of evidence did not address any particular obligations that Mainzeal entered. For example, the directors did not address specific construction contracts that Mainzeal had entered to explain why the directors believed they could meet the obligations under those contracts, and to provide evidence to demonstrate why that belief was reasonable.

[305] The plaintiffs did identify four contracts entered by Mainzeal in one paragraph of their opening submissions — MIT, Ministry of Justice Manukau Precinct, ANZ Tory Street and Wigram Museum — alleging that the directors "failed to turn their mind to whether MPC was incurring obligations in which it could not meet, let alone under the sober assessment of the risks involved for MPC and the creditors associated with [those contracts]". This at least identified particular obligations that could found a claim under s 136, albeit in connection with allegations more naturally associated with s 135.

[306] In order to then pursue such allegations during the trial, it would have been necessary for the plaintiffs to identify what the obligations under those four contracts were, identify when the directors agreed to incur those obligations by entering the contracts, and demonstrate why the directors either did not believe the company would meet those obligations, or did not have reasonable grounds for their beliefs.

[307] At no point did the plaintiffs allege that the directors did not believe they would meet the obligations they were incurring. This was confirmed by the plaintiffs in their closing submissions. So, the allegations were centred on the lack of reasonable

grounds for the belief that the obligations would be met. But, whilst the four contracts referred to in opening submissions were identified in a general way during cross-examination, at no stage were the particular obligations arising from those construction contracts, and any agreement by the directors to the entry of those obligations, put to the directors. Nor were their reasons for believing the contracts would be met challenged.

[308] The relevant contractual documentation was not even put in evidence. Accordingly, the nature and extent of the obligations being entered into, including the length of time that the contractual obligations were to continue, were not identified. In closing submissions, the plaintiffs sought to argue that there was other evidence for these matters. For example, they sought to identify inferences that could be drawn as to the length of time likely to be involved with those contracts from other evidence. I am not prepared to draw inferences from secondary material of this kind. There has been a failure by the plaintiffs to establish the evidence for their case under s 136. The plaintiffs simply did not put their case to the defendants. This was part of Mr Chisholm's criticism of the plaintiffs' case, and I accept it.

[309] My expectation is that, even if the nature of the obligations had been clearly established, it is unlikely that a breach of s 136 would have been established. No doubt, the obligations involved in those contracts contemplated Mainzeal performing them for a reasonably significant period of time. But there is no reason to conclude that the directors either did not believe that those obligations would be fulfilled, or to conclude that the reasons for believing they would be fulfilled were unreasonable. Whilst the directors exposed the creditors to a substantial risk of serious loss, it would not have been apparent to the directors that Mainzeal's failure would occur, or would likely occur immediately, or within a particular period of time, at least until very near to the point when Mainzeal failed. That seems to be critical to establish liability under s 136 in these circumstances.

[310] The evidence suggests that the Wigram Museum contract was entered in November 2011, and the MIT contract in February 2012. There is no reason to suggest the directors would not have reasonably believed contracts entered at that date would be met. Given that ANZ Tory Street appears to have been entered in October 2012,

and the Ministry of Justice Manukau precinct in November 2012, a basis might have existed for a s 136 claim, but in the absence of a proper challenge explored in the evidence, no such conclusions can reasonably be drawn.

[311] For these reasons, I dismiss the plaintiffs' claim for breach of directors' duties under s 136.

THE KFL DEBT RESTRUCTURE

[312] Between January and July 2012, there was a restructuring of the intercompany advances between various entities within the New Zealand division. This restructuring is referred to as the KFL debt restructure. It did not directly involve Mainzeal, but rather its associated New Zealand companies. My earlier factual findings above did not deal with the detail of this restructuring.

[313] The plaintiffs pursue a series of causes of action arising from this restructuring, namely:

(a) A claim that Mr Yan breached ss 131, 135 and 137 of the Companies Act — the sixth cause of action.

(b) A claim that Mr Yan breached his fiduciary duties — the seventh cause of action.

(c) A claim for knowing receipt against the seventh defendant, RGREL, and the eighth defendant, Isola Vineyards Ltd (Isola) — the eighth cause of action.

(d) A claim that transactions were entered into for inadequate consideration, in breach of s 298 of the Companies Act, against RGREL and Isola — the ninth cause of action.

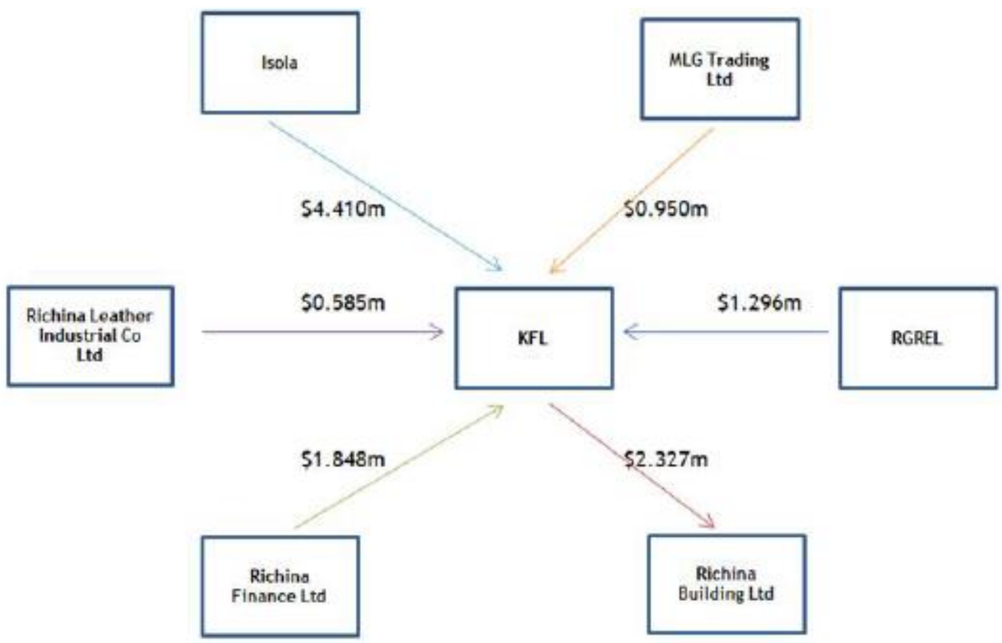
[314] It will be necessary to consider each of those claims in light of the relevant facts surrounding these transactions.

Purpose and effect of KFL debt restructure

[315] There is a degree of complexity surrounding this restructuring. The reason for this complexity is not completely apparent from the evidence, although Mr Yan explained that structures existed for taxation purposes, and I conclude that it is likely that much of it is attributable to this.

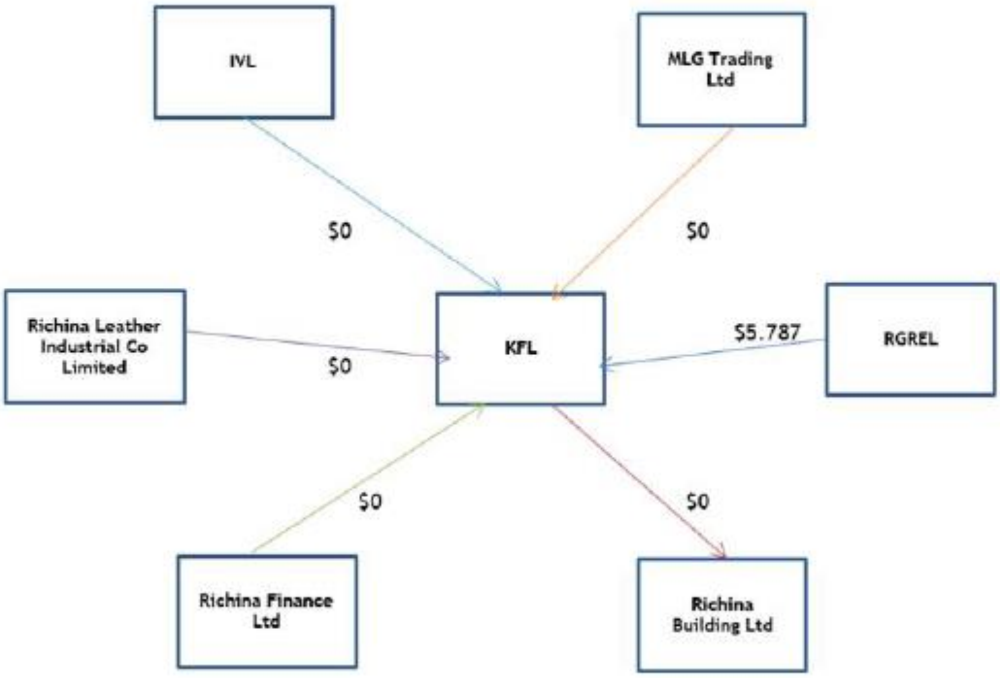
[316] The core facts are not in dispute. In January 2012, the accounts of two of the companies, King Façade (NZ) Ltd and King Façade Ltd ("KFL"), were amalgamated. King Façade (NZ) Ltd was the company that had been involved in importing and installing facade materials sourced from China, and its operations were part of the Pre-Paid Goods Agreement. It had a joint venture arrangement with Chinese entities in that connection. KFL itself was simply a holding company.

[317] Prior to the restructuring, the amalgamated KFL had a series of intercompany balances that had arisen from the operations of the New Zealand division. Those balances can be depicted in the following form:



[318] In addition, KFL owed BNZ $2.246 million and Mainzeal $5.617 million.

[319] After the debts were restructured the receivables from the related parties were all effectively transferred to RGREL. This was depicted as follows:



[320] In addition, the loan documents for the post-restructuring loan between KFL and RGREL provided that the debt was only repayable within 10 years, and only when RGREL was profitable. Significantly, the debt restructure resulted in the elimination of KFL's only external creditor, BNZ, who was repaid. The debt to Mainzeal remained, and subsequently increased in size.

[321] The essence of the plaintiffs' complaints is that, by this restructuring, amounts totalling $9.088 million owed to KFL were replaced with $5.459 million payable by RGREL in 10 years, and only when RGREL was profitable. It is accordingly alleged that this restructuring was clearly detrimental to KFL.

[322] Mr Yan gave evidence that the rationale for the restructure was a desire to preserve KFL's tax losses by bringing KFL under the Mainzeal GST group, and that KFL would ultimately be made a subsidiary in the Mainzeal group to effect this. The steps taken were to simplify the position. Mr Yan also said there was no concern about

the apparent reduction in the value of KFL's intercompany advances because none of the vehicles could or would repay these advances — all ultimately depended on group support. It was always the position that individual intercompany balances could not be called up in isolation.

[323] The evidence concerning this restructuring was otherwise sparse. Mr Yan had little knowledge of the details. In closing submissions, Mr Chisholm, for Mr Yan, said that the plaintiffs had not cross-examined Mr Yan on whether any of the balances could have been recovered before the restructuring. But when he was cross-examined, Mr Yan expressly said he had no memory of the previous intercompany balances, so I do not accept Mr Chisholm's submission. The underlying rationale for the restructuring was not explored with Mr Yan in any depth, however, and I remain very unclear what the reasons for the original intercompany balances were, and what the driving rationale for the restructuring was.

[324] Mr Grant Graham was called by the defendants, and he gave expert accounting evidence that there was no loss caused by the transactions. More extensive cross-examination was undertaken of Mr Graham, which was towards the conclusion of the trial. This was not related to the rationale for the restructuring, but rather the recoverability of advances in a notional liquidation of the companies. Moreover, the central point made by Mr Yan was that none of the balances were recoverable in isolation, as all companies depended on intercompany support. This evidence was not challenged.

[325] For the plaintiffs to contend that this restructuring transaction was advanced in a manner that caused substantial loss and was in breach of the various pleaded directors' duties, in my view it was necessary for them to identify both the reasons for the original intercompany balances, and the driving rational for the restructuring. They did not do so.

[326] I address the particular causes of action against that background.

Sixth and seventh causes of action – breaches of ss 131, 135 and 136 and breach of fiduciary duties

[327] I consider these two causes of action together. They are against Mr Yan. There was initially another defendant, Ms Kwan — an employee of Richina Pacific, who acted as a director in that capacity — but her position was settled during the course of the trial.

[328] These claims include the allegation that Mr Yan was acting in his own interests rather than the best interests of the company. The plaintiffs say that the sixth and seventh causes of action are essentially indistinguishable. That is because a directors' fiduciary duties are equivalent to the duty to act in the best interests of the company under s 131.[61]

[329] There is force in the plaintiffs' point that there is a lack of a clear rationale for the form of the restructuring. Mr Yan was unable to provide an explanation as to why the liabilities were ultimately converted into a contingent liability. It does appear that this was the result of precedent documentation supplied for the transaction by Ernst & Young. But nobody who used those precedents was called as a witness to explain this. Mr Kennedy, for the plaintiffs, argued that there was an intention to build up assets within New Zealand that were not within Mainzeal's control, and this might better explain why there would be an intention for Isola (in particular) not to owe money to KFL. Such a strategy seems generally consistent with Richina Pacific's overall approach — that is, to have assets that provide backing held by related companies, but without that backing being legally enforceable. I accept this is a possible rationale for the restructuring. But the position is far from clear. Two points made by Mr Yan still stand — that the extent of the various intercompany balances was largely irrelevant as everything ultimately hinged on group support, and the transaction was beneficial to KFL because its debt to BNZ was re-paid.

[330] It is clear that KFL functioned as part of the overall group, and the restructuring was for group purposes. KFL's constitution had provisions contemplated by s 131(2) of the Companies Act. That does not absolve directors of their duties set out in the

61 See, for example, *Sojourner v Robb* [2006] 3 NZLR 808 (HC).

Act, but it does mean that the transactions should be looked at in the context of the overall objectives of the group rather than in isolation. Even if the plaintiffs are right that the motivation of this transaction was to establish separate assets outside of Mainzeal as a capital base in New Zealand, challenging the restructuring without directly attacking that general objective is problematic.

[331] Analysing what would have happened if each of the parties had called on the repayment of the advances before and after the restructuring may give some idea of what was in KFL's best interests. But, at the relevant stage, there was no intention to demand repayment of advances. Rather, KFL was continuing as part of a wider group enterprise. In those circumstances, it is necessary to understand what was being achieved, and what the rationale of the restructuring was.

[332] Mr Graham's analysis based on notional liquidations was that these transactions caused no loss. In response, the plaintiffs contend that the appropriate measure of loss for breach of fiduciary duty meant that Mr Yan had an onus to show the transactions were at fair value.[62] The plaintiffs suggested that a restitutionary, or notional account of profits, measure of loss should be adopted.[63] They said that Mr Yan should be ordered to pay $5.719 million compensation to KFL by way of a notional account of profits.[64] But this would require a clear finding of breach of fiduciary duties, or their statutory equivalent. The plaintiffs have not established such breaches to my satisfaction.

[333] I am troubled by the fact that there appears to be a reference to KFL having trade creditors in the amount of $2.791 million. Evidence of this came only from a single document — a KFL balance sheet. This would be particularly significant for a potential claim under s 135, although it would be necessary to demonstrate how the restructuring itself had put those creditors at substantial risk of serious loss. But apart from a reference in that document, there was no other evidence about this. Mr Bethell

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62 See *Morgenstern v Jeffreys* [2014] NZSC 176 at [8].

63 See *Robb v Sojourner* [2007] NZCA 493, [2008] 1 NZLR 751 at [60]–[69]; and *Morgenstern v Jeffreys*, above n 62. This illustrates the importance of properly understanding, and exposing, the real rationale for the transaction.

64 Reliance was also placed on *Kings Wharf Coldstore Ltd (in rec and liq) v Wilson*, above n 33, at [112].

did not explain what those trade creditor liabilities were. When Mr Yan was asked about it, he was surprised as he did not think KFL had trade creditors.

[334] There was clearer evidence in relation to one of the intercompany receivables. Isola's debt to KFL arose as a consequence of the original funding of winery acquisitions on Waiheke. Between November 2010 and April 2011, KFL contributed $4.8 million to the acquisition of the winery property and business at Onetangi Road, Waiheke. It was this debt that was forgiven in the restructuring. Isola was engaged in the winery business. It is now also in liquidation. It has its own creditors. So, it can be said that this restructuring transaction was to the disadvantage of KFL and its creditors, and to the advantage of Isola and its creditors. But KFL's debt to BNZ was paid off, and it accordingly benefited from this. I remain otherwise unclear why the restructuring took place, and who the ultimate winners and losers really were.

[335] For these reasons, I do not believe I can confidently conclude that the restructuring was contrary to KFL's best interests in a manner giving rise to liability as claimed. There are concerning aspects about it, but the evidence was not sufficiently clear to safely draw conclusions, and not all allegations were clearly put to Mr Yan. The plaintiffs have failed to satisfy the burden of proof to establish their claims.

Eighth cause of action: knowing receipt by Isola and RGREL

[336] Under this cause of action, the plaintiffs seek judgment against RGREL, which is the seventh defendant and in liquidation, and Isola, the eighth defendant, which is also in liquidation. The claims are not being defended by the liquidators of RGREL and Isola.

[337] The liquidators have confirmed that Isola's assets include a remaining property in Onetangi Road valued at $1.9 million, 33,000 bottles of wine and $727,518 held in trust by Russell McVeagh.

[338] As indicated, KFL initially advanced funds to buy other properties at Onetangi Road, and the restructuring transaction eliminated that liability. The original advances were undocumented and unsecured advances. They were part of the general

movement of funds in the Richina Pacific group. There was a dispute between the liquidators and Mr Yan as to the original source of this funding, but this does not appear material for the purposes of these allegations.

[339] The plaintiffs contend that Isola knowingly received the property, which had been acquired by Mr Yan's breach of fiduciary duties arising out of the KFL debt restructure. The plaintiffs seek a constructive trust in favour of KFL as a remedy. Mr Kennedy put the allegation in the following way in his closing submissions:

> The plaintiffs say Mr Yan breached his fiduciary duties to KFL in causing the company to enter into the KFL Debt Restructure. Isola and RGREL received a benefit from Mr Yan's breach. RGREL had its current liability to KFL transformed into a contingent liability. Isola had its current liability to KFL discharged but retained the assets acquired with KFL's funds. By reason of the common directors shared with KFL, both Isola and RGREL had knowledge of Mr Yan's breach of fiduciary duties.

[340] The position is complicated by the fact that the actual properties acquired from the money loaned to Isola were sold in 2013. The plaintiffs say they can trace the funds through a series of other transfers undertaken since that time. KFL seeks a declaration that Isola holds the remaining assets referred to above on trust.

[341] I have already held that a breach of fiduciary duty has not been established. That prevents any claim in knowing receipt. Even if that were not the case, I also see considerable difficulty with the tracing the plaintiffs seek once that land had been sold. The claim has many hurdles.

[342] Accordingly, I dismiss the eighth cause of action.

Ninth cause of action: transaction for inadequate consideration

[343] Finally, the liquidators made a claim under s 298(2) of the Companies Act — that the disposition of KFL's property (the debts owed to it by Isola and RGREL) was made for inadequate consideration.

[344] Section 298 provides:

> **298 Transactions for inadequate or excessive consideration with directors and certain other persons**
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> …
>
> (2) Where, within the specified period, a company has disposed of a business or property, or provided services, or issued shares, to—
>
> (a) a person who was, at the time of the disposition, provision, or issue, a director of the company, or a nominee or relative of or a trustee for, or a trustee for a relative of, a director of the company; or
>
> (b) a person, or a relative of a person, who, at the time of the disposition, provision, or issue, had control of the company; or
>
> (c) another company that was, at the time of the disposition, provision, or issue, controlled by a director of the company, or a nominee or relative of or a trustee for, or a trustee for a relative of, a director of the company; or
>
> (d) another company that, at the time of the disposition, provision, or issue, was a related company,—
>
> the liquidator may recover from the person, relative, company, or related company, as the case may be, any amount by which the value of the business, property, or services, or the value of the shares, at the time of the disposition, provision, or issue exceeded the value of any consideration received by the company.
>
> …

[345] Again, the claim is undefended.

[346] I see this claim as potentially in a different category. There was a disposition of property by KFL within the specified period. Given that Mr Yan effectively controlled all of KFL, Isola and RGREL, they were related companies for the purposes of s 298(2)(c).[65] The concept of "property" is broadly defined, and the disposal of property can encompass the assignment/novation of a loan. The transaction here was an assignment/novation to RGREL of Isola's obligation to repay KFL, with RGREL only obliged to repay within 10 years when it was profitable. Isola was released from

65 See Companies Act 1993, s 2(3).

any liability under the transaction. This was a disposition of a right to have a loan repaid. KFL did not itself obtain adequate value for its disposition.

[347] This appears to meet the requirements of s 298(2), as described in *Vance v Bradbury*.[66] The liquidators seek judgment against Isola in the amount of $4.410 million (the value of the loan forgiven). The restructuring documentation dated 31 July 2012 involved Isola acknowledging, and then assigning, a loan of only $2,095,145.76. Mr Yan explained that this amount came about through a series of earlier transactions. On 1 January 2012, $2,447,367.05 was credited by journal entry after another related entity assigned its right to receive a debt in that amount to Isola. Then throughout January 2012 a series of further funds and asset transfers slightly increased the remaining debt owed to KFL, resulting in the figure above. Whatever the form of the transaction, it is clear that in substance Isola only received a benefit of $2,245,525.91, being the value of the BNZ debt that was repaid on its behalf. Although the transactions did not occur simultaneously, I accept Mr Yan's evidence that the BNZ debt would not have been repaid but for the debt restructure.

[348] In those circumstances, I accept that this transaction was for undervalue. Isola was a business with assets, including significant properties, whereas RGREL did not have a strong balance sheet, and the loans on their face were not payable for 10 years, and only when RGREL was profitable. In those circumstances, the loan to RGREL had effectively nil value. The same can be said about the other intercompany loans that existed prior to the debt restructure, with the exception of the Isola debt. I am prepared to proceed on the basis that the loan to Isola as acknowledged did have its face value, at least compared to any residual value in the restructured RGREL loan.

[349] The liquidators are therefore entitled to judgment for the difference between the amount forgiven on the Isola loan and the amount repaid on the BNZ loan, being $2,164,474.09. Giving judgment in favour of KFL as against Isola gives KFL a claim in the liquidation for that amount. That is largely to restore KFL to the position it was in prior to the restructuring, with an unsecured claim against Isola.

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66 *Vance v Bradbury* (2009) 10 NZCLC 264,469 (HC).

[350] The liquidators also seek judgment against RGREL in the amount of $1.309 million. I find that claim more controversial, and I do not uphold it. Under the restructuring transaction, RGREL's liability to KFL substantially increased, albeit not payable until after 10 years, and only when RGREL was profitable. In the absence of more extensive evidence about the reasons for the initial intercompany advances, I am not satisfied that the original advance had any greater value than the restructured advance to RGREL afterwards. In this case, Mr Yan's evidence that all the intercompany advances had no individual value, as they all depended on the group enterprise is persuasive. The position in relation to KFL and Isola is different, as Isola was operating a substantial business with real assets, and KFL had external loans to BNZ that might have been secured over Isola's assets, which were affected by the transaction.[67]

Conclusion on KFL debt restructure claims

[351] Accordingly, I dismiss all the claims in relation to the KFL debt restructuring except for the claim under s 298 of the Companies Act by the fourth plaintiffs against the eighth defendant, in which judgment is entered in the amount of $2,164,474.09.

[352] Standing back and looking at all the claims in relation to the KFL debt restructuring in the round, I am satisfied that this outcome is consistent with legal principle, and leads to the just result. KFL's substantial debt to BNZ was paid off, and the only other asset it had of significance at that time was a loan to Isola. It will now have a claim against Isola in liquidation in approximately the same amount that it had prior to the restructuring after taking into account the elimination of the liability to BNZ.

THE 2012 RESTRUCTURE

[353] The final set of claims relate to a further restructuring. On 24 December 2012, only just over a month before Mainzeal went into receivership, there was a further

[67] The evidence on this was not clear. While BNZ certainly came to have mortgages over Isola's Waiheke properties in late 2012, I have not been able locate any documentation relating to the earlier overdraft facility with BNZ that related to this claim. There were references in the evidence, however, to KFL's overdraft facility being used to fund the purchase of the Waiheke properties, so it stands to reason that there could have been a security interest over them.

restructuring of the Mainzeal group. This was the implementation of the proposals that had been earlier put to the Mainzeal board under the names "Project Shutter" and "Project New Blue". Very broadly, it involved the establishment of a new holding company — Mainzeal Group Ltd ("MGL"), which would become the new owner of Mainzeal. It also involved a reorganisation of intergroup advances.

[354] Once again, the plaintiffs advance multiple causes of action arising out of this restructuring, namely:

(a) the third cause of action by Mainzeal and its liquidators against all the defendant directors (including Sir Paul) for breach of directors' duties under ss 131, 135 and 137;

(b) the fourth cause of action by Mainzeal and its liquidators against Mr Yan for breach of fiduciary duties;

(c) the fifth cause of action by Mainzeal against RGREL for knowing receipt;

(d) the eleventh cause of action by MGL (which is the third plaintiff) and its liquidators against Messrs Yan and Gomm for breach of directors' duties under ss 131, 136 and 137; and

(e) the twelfth cause of action by the liquidators against RGREL for entering into a transaction for excessive consideration in breach of s 298(1)(c) of the Companies Act.

Assignment or novation?

[355] Before dealing with each of the causes of action, it is convenient to deal with one allegation that was central to these claims at the outset, but which is no longer maintained by the plaintiffs.

[356] Under the restructuring arrangements, Mainzeal's immediate holding company, RGREL, sold its Mainzeal shares to MGL for $17.55 million. Part of the

purchase price for this sale was met by an assignment to MGL of amounts payable by RGREL to Mainzeal in the amount of $15.15 million. That is, MGL would now owe Mainzeal what RGREL had owed Mainzeal. The assignment was noted in the resolution of Mainzeal's board approving of the transfer of shares.

[357] Part of the plaintiffs' original case was that this transaction was adverse to Mainzeal as the assignment of RGREL's substantial obligation was not in Mainzeal's best interests. That allegation was made on the basis that RGREL was released from its obligations to Mainzeal. The key issue here was whether this was only an assignment (in which case RGREL would remain liable) or whether it was a novation (in which case it was released).[68] There was a difference of view between Dame Jenny, Sir Paul, Mr Gomm and Mr Tilby on the one hand (who said it was only an assignment) and Mr Yan on the other (who said it was a novation). It is apparent that this question was raised at the time by the Mainzeal directors other than Mr Yan, particularly in discussions between Mr Tilby and Sir Paul, where Sir Paul had given reassurance on the basis that Mainzeal was not a party to the assignment contract/s. Mr Pearce also indicated to the directors that the transfer of shares "in no way extinguishes obligations or liabilities or transfers assets out of Mainzeal". I also accept the evidence of the directors that, in considering the transaction overall, the directors were careful to ensure it did not involve any potential loss to Mainzeal's creditors.

[358] On 27 February 2014, RGREL was initially placed into liquidation by the High Court,[69] but on 20 May 2014 the Court of Appeal set aside the liquidation order, as there were disputes as to RGREL's liabilities that could not be properly resolved in an application in a liquidation proceeding.[70] Mr Yan had sworn an affidavit in that proceeding that included his view that a novation was intended and the RGREL accordingly had no liability. RGREL was later put into liquidation, however.

[359] In closing submissions, the plaintiffs accepted that this transfer was only an assignment, and not a novation. The basis for alleging that Mainzeal had formally

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68 For the distinction, see *Savvy Vineyards 3552 Ltd v Kakaru Estate Ltd* [2014] NZSC 121, [2015] 1 NZLR 281.

69 *Mainzeal Property and Construction Ltd (in rec and in liq) v Richina Global Real Estate Ltd* [2014] NZHC 277.

70 *Yan v Mainzeal Property and Construction Ltd (in rec and in liq)* [2014] NZCA 190.

consented to the release of RGREL's liability was the Mainzeal board resolution approving the transaction. This resolution did not record that this was a novation, and no other contractual documents recorded an agreement by which Mainzeal released RGREL. I accordingly proceed on the basis that the transaction was an assignment and not a novation.

[360] The plaintiffs nevertheless maintained criticisms of the transaction, including because the directors did not take independent legal advice before entering it, and because there was a degree of ambiguity about the arrangements leading to the difference of view between Mr Yan and the other Mainzeal directors. The plaintiffs said that "[h]ad the directors taken the time and advice to determine the scope and effect of the transaction, and to record that assignment only was intended, there would have been no uncertainty as to its effect". The plaintiffs advanced their claims against that background.

Third cause of action – breach of directors' duties under ss 131, 135 and 137

[361] The plaintiffs relied on the duties of directors to act in good faith and in the best interests of the company as summarised by Fogarty J in *Sojourner v Robb*.[71] This is particularly reflected in s 131. They also referred to the directors' duty of care under s 137, and the reliance upon advice set out in s 138.

[362] The plaintiffs say that the directors failed to get a comprehensive recommendation from management, or professional advice as to the legal and financial implications. They also say there were not proper discussions at the board level involving Mr Yan concerning the purpose and effect of the transaction. They put their claim in the following way in closing submissions:

> The directors failed to take these steps that should have been taken to ensure that the transaction was clearly recorded as an assignment and not a novation. The failure to do so led to the situation that followed, whereby Mr Yan was able to contend novation and successfully avoid a timely liquidation of RGREL.

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[71] *Sojourner v Robb*, above n 61, at [102].

[363] I see no basis for the plaintiffs' allegations. I agree that it would have been preferable for the directors to take independent legal advice, especially because of the difficult financial position that Mainzeal was then in. But once it is accepted that this is not a novation, then it is very difficult to see how the directors breached any duties. They placed reliance on the professional advice made available by the Richina Pacific group, the work of management on this concept throughout 2012, and the earlier advice from Ernst & Young on the proposals. The Mainzeal directors also had the advantage of the considerable commercial experience of Sir Paul. The concept of the transaction had been scrutinised during the year. In those circumstances, I am not prepared to conclude that the directors breached their duties simply by relying on these sources rather than external legal advice.

[364] It follows that I do not need to make an assessment of whether there could be said to be any loss arising from this alleged breach. Given that the liquidators now accept that there was no novation, and that RGREL is now in liquidation, I find it difficult to see how any loss arises in the absence of clear evidence that the delayed liquidation of RGREL created a specific identifiable loss. I would not have been prepared to presume financial loss simply from the delay caused by Mr Yan's ability to resist the liquidation of RGREL for a period of time.

Fourth and fifth causes of action – breach of fiduciary duty by Mr Yan and knowing receipt by RGREL

[365] The plaintiffs claim against Mr Yan because they say he breached his fiduciary duties not to profit personally from his position as director, not to allow a conflict of interest between his duty of loyalty to the company and his self-interest, and to exercise powers in the best interests of the company.[72]

[366] Here it is alleged that, in breach of those duties, Mr Yan intended to release RGREL from its liability to Mainzeal. It is said he did so in a position of conflict of interest, without consciously giving separate consideration to Mainzeal's interests. The plaintiffs say that Mr Yan should be ordered to pay Mainzeal's loss of $15.15 million, or a substantial part of it.

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72 *Baroni v Crotty* (2006) 3 NZCCLR 261 (HC) at [132]. See also *Sojourner v Robb*, above n 61, at [18], approved on appeal in *Robb v Sojourner*, above n 63.

[367] I see the liquidators' concession that RGREL was not released from its liability to Mainzeal as fatal to this claim as well. No loss of this nature has been caused. Irrespective of what Mr Yan thought was the effect of these transactions, it is now accepted by the liquidators that his view was incorrect. RGREL remains liable. I do not need to address the issue of whether there would have been a breach of fiduciary duties if the transaction had the effect that Mr Yan said it did. I simply note in this respect that Mr Graham gave evidence that there would be no loss caused in this event, albeit his evidence was disputed. I also note that some of the additional SBLC funding from Richina Pacific was introduced during this restructuring, which was of benefit to both Mainzeal and MGL.

[368] I see no substance in this claim and it is dismissed. There is also a claim by the liquidators against RGREL for knowing receipt. But I was advised in closing submissions that this cause of action was only pursued if the Court decided there had been a novation. Accordingly, it is also dismissed.

Eleventh cause of action – breach of directors' duties in relation to the purchase of Mainzeal shares by MGL

[369] This cause of action focuses on the other side of the transaction — that is, the MGL side. MGL is the third plaintiff. MGL and its liquidators allege that the directors of MGL at the time of these restructuring transactions, Mr Yan and Mr Gomm, failed to discharge their duties to the company under ss 131, 136 and 137 by entering the sale of shares agreement. In closing submissions, the plaintiffs focused on s 136, and contended that MGL had no income and no assets that could be used to pay the agreed purchase price of $17.551 million. They alleged that the agreement came within the category summarised by Lang J in *Goatlands Ltd (in liq) v Borrell* of a contract that had the potential to cause MGL's demise.[73]

[370] The allegations seem to me to be misconceived. The enquiry under s 136 is whether the directors reasonably believed the company would be able to meet the obligations it was entering. The transaction in issue here is the acquisition of the shares. Section 136 requires the directors to reasonably believe that the purchase price

[73] *Goatlands Ltd (in liq) v Borrell*, above n 22, at [46].

obligations would be met. But those obligations were in fact met by the assignment to MGL of the $15.15 million debt payable by RGREL to Mainzeal. The balance of the purchase price remained in as vendor finance from RGREL. The plaintiffs do not appear to pursue this cause of action with respect to the vendor finance, as they only seek a contribution of $15.551 million under this cause of action. Given that the transaction was actually performed in relation to $15.15 million, the allegation that the directors did not believe that MGL would satisfy this obligation has no basis.

[371] I accept a question could be raised about MGL's performance of the consequential liability to Mainzeal, even though this does not seem to be the basis of the allegation. But even then, whether MGL would be called upon by Mainzeal to repay the amount MGL now owed to it was a matter of the overall group decision making. Mainzeal was a wholly-owned subsidiary of MGL, and could be obliged to act in MGL's best interests under s 131(2). The directors had no reason to believe that MGL would be unable to meet any such obligation in those circumstances. I also accept the submissions of Mr Chisholm for Mr Yan, and Mr Hodder for Mr Gomm, that it is important all MGL's creditors, and MGL's shareholders, approved of the restructuring transaction. So any risks associated with the transaction were known to, and accepted by, all those affected. It is also relevant that MGL has now itself been placed into liquidation, and its assets have been pooled under s 271(1)(b).

[372] Had it come to it, for those reasons, I would also have concluded that an award of compensation under s 301 would not have been appropriate. These were simply group transactions designed to restructure the group so that Mainzeal would now be a subsidiary of MGL. As the new holding company, MGL was responsible for the liability of the previous holding company, RGREL. In a broader sense, the restructuring was intended to make it easier for Mainzeal's business undertaking, now under the ownership of MGL, to be financed going forward.

[373] In those circumstances, I see no basis for this claim and it is dismissed.

Twelfth cause of action – transaction or excessive consideration: MGL

[374] Finally, the plaintiffs contend that MGL should recover against RGREL the amount by which the value of the consideration given for the acquisition of the

Mainzeal shares exceeded the value of the shares at the time of acquisition under s 298(1)(c) of the Companies Act. This cause of action is against RGREL itself, and accordingly it is undefended.

[375] The plaintiffs rely on the decision of the Supreme Court in *Morgenstern v Jeffreys* for the proposition that where a director sells an asset of a related company, the director has an onus, as a fiduciary, to establish a fair value, which, in the absence of a contemporaneous valuation, may be difficult to discharge.[74]

[376] The plaintiffs say that there was no contemporaneous independent valuation. There was a valuation from Mainzeal's Chief Financial Officer, Mr Pearce, but the plaintiffs say that this falls short of the required standards. The plaintiffs accounting expert, Mr Apps, gave a valuation opinion, and he said that the Mainzeal shares had no value at this time.

[377] I do not think there is any merit in these allegations either. Mainzeal had value as an enterprise if it was supported by Richina Pacific as a going concern. Without that support, it effectively had a nil value. Equally, RGREL's obligation to Mainzeal in the amount of $15.15 million would never have been called up given that Mainzeal could be directed to act in RGREL's best interests. Whilst it continued to trade, the loan would never be called up by Mainzeal against either RGREL or MGL. In those circumstances, I fail to see how the plaintiffs have proved that the transaction was for excessive consideration. These were only paper transactions to exchange MGL for RGREL as Mainzeal's holding company, with no real external value considerations.

[378] This cause of action is also dismissed.

QUANTUM

[379] The above findings mean that the only claim that has succeeded is the second cause of action against the first to fourth defendants, although I have also upheld the ninth cause of action by the fourth plaintiffs against the eighth defendant.

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74 *Morgenstern v Jeffreys*, above n 32, at [8].

[380] Having established a breach of s 135 under the second cause of action, it is appropriate to assess whether orders should be made under s 301 of the Act against the first to fourth defendants. That section provides:

> **301 Power of court to require persons to repay money or return property**
>
> (1) If, in the course of the liquidation of a company, it appears to the court that a person who has taken part in the formation or promotion of the company, or a past or present director, manager, administrator, liquidator, or receiver of the company, has misapplied, or retained, or become liable or accountable for, money or property of the company, or been guilty of negligence, default, or breach of duty or trust in relation to the company, the court may, on the application of the liquidator or a creditor or shareholder,—
>
> (a) inquire into the conduct of the promoter, director, manager, administrator, liquidator, or receiver; and
>
> (b) order that person—
>
> (i) to repay or restore the money or property or any part of it with interest at a rate the court thinks just; or
>
> (ii) to contribute such sum to the assets of the company by way of compensation as the court thinks just; or
>
> (c) where the application is made by a creditor, order that person to pay or transfer the money or property or any part of it with interest at a rate the court thinks just to the creditor.
>
> (2) This section has effect even though the conduct may constitute an offence.
>
> (3) An order for payment of money under this section is deemed to be a final judgment within the meaning of section 17(1)(a) of the Insolvency Act 2006.
>
> (4) In making an order under subsection (1) against a past or present director, the court must, where relevant, take into account any action that person took for the appointment of an administrator to the company under Part 15A.

[381] Mr Chisholm submitted that s 301 is a compensatory provision rather than a punitive one.[75] I accept that is so, but the level of contribution the Court may order

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75 He particularly relied on *Re Continental Assurance Co of London PLC (in liq) (No 4)* [2007] 2 BCLC 287 (Ch).

does involve considering issues of culpability and deterrence.[76] In *Mason v Lewis*, the Court of Appeal held in relation to the application of s 301 to a breach of s 135:[77]

> [109] The standard approach has been to begin by looking to the deterioration in the company's financial position between the date inadequate corporate governance became evident (really the "breach" date) and the date of liquidation.
>
> [110] Once that figure has been ascertained, New Zealand Courts have seen three factors - causation, culpability, and the duration of the trading - as being distinctly relevant to the exercise of the Court's discretion (see *Re Bennett, Keane & White Ltd (in liq) (No 2)* (1988) 4 NZCLC 64,317 per Eichelbaum J; and *Löwer v Traveller*, which endorsed those principles).

[382] The plaintiffs advanced two alternative ways of assessing quantum in this case:

(a) First, an approach they described as the "new debt approach", which focused on the loss to new creditors arising after the counterfactual dates that they alleged.

(b) Second, the approach normally applied to reckless trading cases set out by the Court of Appeal in *Mason v Lewis*.

New debt approach

[383] Mr O'Brien's argument in support of the "new debt approach" is based on the views of Mr Gabriel Moss QC, who has been critical of the approach to assessing loss that has been adopted in England and Wales. The English approach is similar to the one adopted by our courts in *Mason v Lewis*. The criticism is based on the fact that a distressed company trading on will incur new obligations, but, provided the net position of all creditors is not made worse by trading on, the creditors to whom those new obligations were owed will have no remedy. In the words of Mr Moss:[78]

> If a director at the critical date realised or ought to have realised that the company was bound to go into insolvent liquidation or administration and yet failed to minimise loss to creditors, they should in principle be liable to contribute to the assets of the company to the extent that new liabilities were taken on after the critical date and yet not paid. Otherwise there appears to be

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76 *Löwer v Traveller*, above n 12 at [83].

77 *Mason v Lewis*, above n 11.

78 Gabriel Moss "No compensation for wrongful trading – where did it all go wrong?" (2017) 30(4) Insolv Int 49 at 49.

> no principled basis to wrongful trading and no effective remedy, unless the net deficit happens to go up. The activity of taking on new debt with no reasonable prospect of payment and using the money in paying off old creditors, assuming it to take place without any desire to prefer, will be free of any effective remedy.

[384] Mr Peter Watts QC has disagreed with these views, indicating that there is no real reason to provide a remedy when the company is improving its net position by trading on, or only treading water.[79]

[385] The New Zealand provisions are different in that s 136 is directed to the entry of a particular obligation, and accordingly contemplates the position of a particular creditor. But similar issues arise in relation to the application of s 301, including whether ss 301(b)(i) or (c) should be applied when there is a breach of s 136. Nothing I say below should be taken to express a view on such questions.

[386] In the present case, I accept the arguments of Messrs Hodder and Chisholm that Mr Moss' approach should not be used in relation to a breach of s 135. In part, this is because the duties that directors have are owed to the company and not the individual creditors. It is the loss to the company caused by the directors' breach of duty that is the focus. That loss is represented by the claims of creditors overall in an insolvency.

[387] This may not have been a complete answer to Mr Moss' suggestion, however. An individual creditor's loss could still be the company's loss precisely because the breach of duty to the company has given rise to that claim against the company. The key reason why Mr Moss' approach is not available in New Zealand (with respect to a breach of s 135) is that any claimant under s 301 for this kind of breach is not able to pursue a claim that benefits an individual creditor as opposed to the creditors overall. The relevant order is "to contribute such sum to the assets of the company by way of compensation as the court thinks just" under s 301(1)(b)(ii), as an action for breach of directors' duties under s 135 does not fit with the remedy provided by s 301(1)(b)(i) which relates to repaying money or restoring property. The liquidator receiving an amount under s 301 has an obligation to all creditors, which he or she

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79 Peter Watts "Recouping Liquidation Costs through Litigation against Directors – a Dubious Practice" (20 July 2018) Oxford Business Law Blog <www.law.ox.ac.uk/business-law-blog>.

must treat in a pari passu manner. A liquidator cannot distribute the proceeds to some creditors at the expense of other creditors. Neither can creditors themselves seek a remedy for breach of s 135 under s 301(1)(c).[80]

[388] The plaintiffs sought to address this difficulty by calculating their claim for loss based on the overall liabilities to creditors. They focused on new debts that were incurred after the breach dates, and then made adjustments calculated by reference to the net position of all creditors. That was alleged to bring the approach within s 301(1)(b)(ii). This involved the following:

(a) for creditors whose debts increased from the counterfactual date, the amount of the increase was allowed in the loss calculation;

(b) for creditors whose liability decreased, no deduction was made;

(c) for creditors who were not creditors at all at the counterfactual date, the full amount of the debt was allowed; and

(d) for creditors who existed at the counterfactual date, but not at liquidation, no deduction was made.

[389] This resulted in a claim for \$69.427/\$75.348 million compared with \$32.849/\$44.494 million under the *Mason v Lewis* formula.

[390] This ungainly hybrid does not do justice to Mr Moss' call for a principled remedy. Neither does this approach confront the issue that the liquidator must distribute pari passu to all creditors, so that the new creditors do not get fully compensated in any event. For these reasons, I do not accept this is an available approach to awarding compensation for a breach of the duty under s 135 in relation to the action bought under s 301.

[391] In any event, for the reasons I elaborate on below, applying this approach to quantum is not appropriate in the present case for another reason. The loss caused by

80 See *Mitchell v Hesketh* (1998) 8 NZCLC 261,559 (HC).

the directors' breach is not identified by this calculation. This is not a case where the directors have improperly continued to trade a company destined to fail and created further losses to creditors in doing so. I will elaborate on my reasons for this view when addressing the *Mason v Lewis* approach below.

Should the *Mason v Lewis* approach be applied?

[392] The plaintiffs' alternative approach follows *Mason v Lewis*, which involves identifying the further losses created by trading on from an earlier notional liquidation of the company. The plaintiffs allege that the directors were in breach of their obligations under s 135 in January 2011, or July 2011. This was taken as the "counterfactual" date for the purpose of an earlier liquidation, and the assessment contemplated by *Mason v Lewis*.

[393] Notwithstanding that the plaintiffs pursued their claim on this basis, and the extensive evidence called by both the plaintiffs and defendants to address this approach, I have concluded that it is not appropriate to apply the *Mason v Lewis* approach in this case. This is because the loss caused by the directors' breach is not identified by applying this formula.

[394] The *Mason v Lewis* assessment is directed to the situation where directors of a company continue to trade in circumstances where it was inappropriate to do so. In particular, where the courts have found the directors should have ceased trading at an earlier date, this being the counterfactual date. It is the failure to cease trading earlier that constitutes the breach of directors' duties. The loss caused in these circumstances is the deterioration of the company's financial position caused by trading on.

[395] But that is not the nature of the directors' breach in the present case. I have accepted the plaintiffs' contention that the directors breached their duties by continuing to trade the company in a particular manner — by way of summary, by trading it while it was insolvent, while relying on what were informal assurances of group support that were not reliable. Given the financial trading position, this exposed the creditors to the risk of loss arising from the company's failure, which is the very risk that came to fruition.

[396] But equally, I accept the strongly expressed views of the defendants that there was no reason for the directors to have put Mainzeal into receivership or liquidation at the January or July 2011 dates. Mr Yan described that suggestion as ridiculous, and he outlined the extensive projects that Mainzeal was working on at that stage, including in China. Mr Walker said that the idea was ludicrous and foolhardy. All the directors gave evidence consistent with these views.

[397] There is also the further related feature that may distinguish this case from many other reckless trading cases. At its insolvency, Mainzeal had existing trade creditors. But it also had significant construction contracts on foot. The very act of ceasing to trade would have created huge further losses arising from its failure to continue with these contractual obligations. As Sir Paul said, the consequences of liquidation would be "horrific". Ceasing to trade would have transformed assets into liabilities — turning profitable contracts into claims against the company. In the liquidation, there are claims of approximately $43.8 million arising from Mainzeal's failure to continue to perform its construction contracts. Other claims in the liquidation are likely to have arisen by the losses created by ceasing trade. The same applies to any earlier liquidation — indeed the defendants say that had Mainzeal been liquidated in January or July 2011, very significant losses would have been created by it ceasing to perform the contracts in existence at that time, which were then larger in number. That is why there is considerable force in the view of Mr Yan, and Mr Walker, that ceasing to trade would have been ridiculous/foolhardy. Liquidation was the very thing that reasonable directors would want to avoid.

[398] The breach of the directors' duties in this case did not arise because the directors failed to cease trade and put Mainzeal in liquidation or receivership in January 2011. The breach of directors' duties arose because they caused, agreed or allowed Mainzeal to engage in trade in a vulnerable state — being balance sheet insolvent, with a poor financial trading position, and depending on assurances of support in a way I have found to be unreasonable. As previously indicated, s 135 is directed to the "manner" in which the business of the company is being carried on. The manner in issue in this case involves trading in this vulnerable state. It is not focused on continuing to trade a company that was likely to fail in any event and thereby creating further losses.

[399] The plaintiffs themselves do not contend that the directors should have liquidated Mainzeal at the counterfactual date. But they contend that, had the directors decided not to continue to trade the company in a manner breaching s 135, this would ultimately have led to liquidation. This is their basis for contending that the *Mason v Lewis* approach should apply.

[400] I do not accept this. Mainzeal only collapsed because it traded in the vulnerable state created by the group, which the directors agreed to. This created a substantial risk of serious loss to the creditors, being the very loss that came to fruition. In effect, that was the defendants evidence. The receivership and liquidation arose because of immediate cash flow issues, and because the Richina Pacific group withdrew its support. Had Richina Pacific been legally committed to provide support, then in my view failure would not have occurred.

[401] But the directors must face the ultimate responsibility for the vulnerable trading given that it is their responsibility to determine the manner of trading, and the directors have the duty not to trade in a manner causing a substantial risk of serious loss to creditors. If Mainzeal had not engaged in this vulnerable trading, for example if it had been properly capitalised, it would not have failed at all, even taking into account the poor performance over the years, and its vulnerability to significant one-off losses. Failure would not have occurred had the directors complied with their duties.

Can an alternative approach be applied?

[402] Given the above findings, what is the appropriate way in which to assess compensation under s 301 for breach of s 135?

[403] During the course of the hearing, I alerted the parties to the possibility that compensation might be approached by the Court on the basis different from that advanced by the plaintiffs. This was potentially based around the full extent of the loss on liquidation as a starting point. That was explained in my minutes of 25 October 2018 and 2 November 2018. Those minutes explained the rationale for assessing compensation on that basis. I raised the position formally with the parties because it seemed to me to be important that both the plaintiffs and the defendants had the

opportunity to address it. In the case of the defendants, I raised it because I thought it was necessary by way of procedural fairness to give them the right to apply to call or recall evidence. Both Mr Chisholm and Mr Hodder indicated after my minute of 2 November 2018 that they did not intend to apply to call further evidence or recall witnesses.

[404] In my view, it is permissible for the Court to assess quantum on a basis other than on the basis contended for by the plaintiffs, particularly when the Court is exercising a statutory power, and where the statute contemplates the Court conducting an inquiry and then making an award of compensation as the Court thinks just. Caution needs to be applied if the Court is considering doing so, however. The Court needs to be satisfied it has the evidence required for assessing quantum on an alternative basis, and it is also necessary for the Court to be sure that it meets the requirements for procedural fairness.

[405] Messrs Chisholm and Hodder argued in closing submissions that the plaintiffs' claims should be dismissed should the Court conclude that no loss arose under the *Mason v Lewis* approach, or if it concluded that the *Mason v Lewis* approach was not appropriate.[81] I do not accept that. The fact that I have not accepted the plaintiffs' allegations that are the basis for their calculation of loss does not mean that there is no loss arising from the breach. Under s 301, after conducting an inquiry, the Court is required to determine the amount of compensation that the breaching directors should contribute that the Court thinks just. Previous cases have awarded compensation for breach of duties without overtly applying the *Mason v Lewis* approach.[82] The Court

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81 Reliance was placed on *Brooks v Armstrong* [2016] EWHC 2893 (Ch), where the Court held that a claim should have been dismissed in similar circumstances. However, the position in the United Kingdom is relevantly different from New Zealand. Under s 214 of the Insolvency Act 1986 (UK) — the broad equivalent to s 135 of the Companies Act 1993 — the relevant requirement for breach is that "at some time before the commencement of the winding up of the company, [the director] knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation". It appears that liability of the kind found in this case — where the failure of the company was not unavoidable — would be unavailable under the United Kingdom legislation.

82 *Re Hilltop Group Ltd (in liq)* (2001) 9 NZCLC 262,477 (HC) at [48]–[49]; *Rowmata Holdings Ltd (in liq) v Hildred* [2013] NZHC 2435; *Goatlands Ltd (in liq) v Borrell*, above n 22; *Willburn Furniture and Restorations Ltd (in liq) v Gledhill* [2016] NZHC 331 at [69]–[73]; *Shannon Agricultural Consulting Ltd (in liq) v Shannon* [2015] NZHC 1133 at [36]–[38]; *Kiwi Best Realty Ltd (in liq) v Kashkari* [2016] NZHC 2738 at [41]–[56]; *Hansa Ltd (in liq) v Hibbs* [2017] NZHC 2014 at [58]–[60]; and *Debut Homes Ltd (in liq) v Cooper* [2018] NZHC 453, (2018) 12 NZCLC 98-059 at [83]–[86].

has previously awarded the full amount of the deficiency on liquidation, or made observations to the effect that such an outcome would be possible.[83] On the basis of the authorities, including *Mason v Lewis*, the starting point is to ascertain the loss caused by the breach, and then to apply discretionary factors to determine what the just contribution is. That seems to me to be the guiding principle.

[406] I am not persuaded that there has been any procedural unfairness arising from adopting an alternative approach. The plaintiffs did not put the alternative approach of quantum more specifically to the defendants in cross-examination. But I do not think there would have been any advantage in recalling the defendants for that purpose, even if the opportunity to recall witnesses had been taken up by the defendants. The underlying events were all covered comprehensively in evidence, and exploring the matters further in cross-examination could realistically do no more than elicit opinion evidence that is better addressed in submissions in any event.

[407] It is, perhaps, surprising that the plaintiffs did not seek leave to amend their pleadings to squarely advance a claim for quantum on the basis suggested in my minutes. Indeed, the plaintiffs sought to amend their pleadings after those minutes were issued on a different basis again, but withdrew that application during the course of the argument concerning the proposed amendment. The plaintiffs did not, however, disclaim reliance on the alternative basis I had raised. It is accordingly appropriate for me to make the assessment contemplated by s 301 on the basis of the evidence I have heard, and the submissions I have received, but nevertheless proceeding with caution.

Overview of the approach

[408] It is necessary to go back to first principles. Those include the principles already addressed when analysing the s 135 requirements. The Court is exercising a discretion under s 301. The starting point is the loss to creditors caused by the breach that has been found to exist. That does not involve the stricter approach to

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[83] *Willburn Furniture and Restorations Ltd (in liq) v Gledhill*, above n 82, at [73]; *Re Hilltop Group (in liq)*, above n 82, at [48]; *Shannon Agricultural Consulting Ltd (in liq) v Shannon*, above n 82, at [38]; *Hansa Ltd (in liq) v Hibbs*, above n 82, at [58]–[60]; *Bay Metal Fabricators Ltd (in liq) v Steenson* [2016] NZHC 1634 at [56]–[57]; *O'Neill Earthworks Ltd (in liq) v O'Neill* [2017] NZHC 989 at [61]–[63]; and *Superior Blocklayers Ltd (in liq) v Bacon* [2016] NZHC 2601, (2016) 14 TCLR 425 at [56]–[59].

compensation applicable to breach of fiduciary duty.[84] I accept Mr Chisholm's argument that causation is critical, and Mr Hodder's related submission that a causal chain linking breach and loss must be established.

[409] I also readily accept the submissions for the defendants that s 301 is not, in itself, a section that establishes a right of recovery. It merely provides a procedural mechanism for rights that arise elsewhere — here, for breach of s 135.[85] A loss caused by the breach of s 135 must first be established before subject to recovery under s 301.

[410] In *Re South Pacific Shipping Ltd (in liq)*, William Young J concluded that the starting point for the liability of a director was "the possibility of an order requiring him to meet all the debts of [the company] as at the date of liquidation".[86] He then deducted from that amount the substantial losses to creditors that would have arisen had the company ceased trading at an earlier point because the director was "entitled to some sort of credit for the losses which would have been suffered if he had not acted in breach …"[87] On appeal, the Court of Appeal accepted that the approach the Judge adopted was open to him, noting that the Judge had recorded there were a "number of different ways in which the assessment of loss could be approached and the approach he followed was not the sole basis for his decision".[88] In doing so, McGrath J, for the Court, said in relation to the equivalent of s 301 under the Companies Act 1955:

> [78] Section 320 of the 1955 Act conferred a power on the Court in the exercise of its judgment, if it thought it proper to do so, to impose personal liability without limitation on an impugned officer of a company for all or any part of its debts. The principal purpose of the section was to compensate those who suffered loss as a result of illegitimate trading, the extent of the required contribution being a matter for the Court's judgment. The factors of particular relevance to the exercise of the Court's judgment concerning the amount of a declaration under s 320 are causation, culpability and duration: *Re Bennett, Keane & White Ltd (in liq) (No 2)* (1988) 4 NZCLC 64,317 per Eichelbaum J.
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> [79] The element of causation is concerned with the link between the carrying on of the company's business recklessly, to the knowledge of the impugned director, and the indebtedness of the company for which it is sought to impose personal liability. In a case such as the present that involves an assessment of how much the liabilities of the company were increased because

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84 See *FXHT Fund Managers Ltd (in liq) v Oberholster* [2010] NZCA 197 at [26]–[31].

85 Notwithstanding the submissions of enthusiastic counsel on more than one occasion — see *Benton v Priore* [2003] 1 NZLR 564 (HC) at [40]–[47].

86 *Re South Pacific Shipping Ltd (in liq)*, above n 13, at [164].

87 At [164](2).

88 *Löwer v Traveller*, above n 12, at [90].

> of the illegitimate delay in its ceasing to trade and the identification of a point in time when the director knew that continuing to trade would be reckless. The resulting figure however is no more than a relevant consideration for the Court although the amount of the director's liability would not exceed the sum identified as caused by the known reckless trading.

[411] These observations are consistent with the possibility of assessing compensation on a basis other than the *Mason v Lewis* formula if appropriate in a particular case.

[412] These points also respond to the argument by Mr Chisholm that recognising recovery on the alternative basis that I proposed would mean that the *Mason v Lewis* formulation "would quickly be replaced". That is not so precisely because of the need to establish causation. If directors breach their s 135 duty by continuing to trade a company that should be liquidated, the directors will only be liable for the additional loss to creditors that they cause by failing to cease trading. But if the s 135 breach of arises by creating a substantial risk of failure for a company that should otherwise not fail, then the loss caused by the breach is the loss created by that failure.

[413] In this latter case, the discretionary considerations may become more significant, however. In the end, s 301 involves a discretion and the exercise of judgment. I am guided by the need for the assessment to be rational, reasonable and, ultimately, just. McGrath J also stated, in his characteristically perceptive way, that when assessing compensation the Court should be both conservative and cautious if there are uncertainties.[89]

Identifying the starting point

[414] I have accepted the defendants' submissions that causation must be established on the evidence. But I do not accept Mr Chisholm's argument that there is no evidence for the proposition that the directors caused the full loss on insolvency. The evidence surrounding the events that caused the liquidation has been provided in a comprehensive way.

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89 *Löwer v Traveller*, above n 12, at [80].

[415] The loss to creditors that did materialise here — the $110 million loss on liquidation — is the very loss the directors exposed the creditors to by the conduct in breach of s 135. That loss is directly attributable to the breach. I accept that the position would be different if Mainzeal was likely to have failed in any event. But that is not the position. Its failure only arose because of the manner in which the company conducted business, being the manner that gives rise to the breach of duties. Even at the very end, it was Richina Pacific's advice that support would not be continued that caused BNZ to appoint receivers, which ultimately led to the liquidation.

[416] It was the Richina Pacific group that had procured Mainzeal to conduct its business in a way that led to the breach of duties by the directors. But I do not think it is necessary to conduct a more elaborate analysis of what was likely to have happened if the directors had declined to agree to the business being conducted in this manner. It is unnecessary to establish that the directors could successfully have stopped the group from procuring the illegitimate trading. This is unnecessary to establish the required causative link between the loss on liquidation and the directors' breach. It is sufficient to establish that the serious loss to creditors arose from the manner of trading that the directors had the duty not to engage in. Moreover, to some extent asking whether the directors would have succeeded in persuading the group to change involves a degree of speculation, or at least considerable uncertainties.

[417] Even if it is necessary to engage in that analysis, and thereby determine whether the directors could successfully have forced the group to abandon the vulnerable trading approach, in my view the directors would have been successful in doing so.

[418] The directors first took legal advice on their duties in December 2012. Had they taken this advice at an earlier point, it is likely that it would have been provided in equivalent terms, including advice that the commitments the directors were relying on needed to be documented in a legally binding way. The directors could have refused to continue as directors if this did not happen. In any event, irrespective of how the issue would have precisely been addressed, it would have been necessary for the directors to insist on resolving the problems arising from the insolvency caused by

the irrecoverability of the intercompany debts, if necessary to the point of resignation if the problems were not resolved.[90]

[419] Had the directors taken the stance that the company needed to be made solvent, the evidence suggests that there were three possible ways in which Richina Pacific could have responded other than placing the company into liquidation, namely:

(a) it could have taken steps to recapitalise Mainzeal, to allow it to operate completely separately from Richina Pacific;

(b) the previous written assurances set out in the annual audit letters could have been recorded in a legally binding commitment in the same terms — essentially guaranteeing support to maintain solvency; or

(c) some more limited form of legally binding and efficacious support, sufficient to restore solvency, could have been provided.

[420] The evidence included a number of assessments of the amount that was needed to properly recapitalise Mainzeal. First, in 2008/2009, Vero advised that, to replace Richina Pacific with a New Zealand based bond guarantor, $40 million of capital needed to be introduced. That figure corresponds to the level of the related party receivables at the time, which reflected the amount of capital that had been extracted from Mainzeal by Richina Pacific. There are alternative assessments. PwC had assessed, at the same time, that $20 million of capital was required to properly recapitalise Mainzeal. That figure corresponds with the figure that Sir Paul assessed was required in 2012, once he had familiarised himself with the company's position. In closing submissions, the plaintiffs suggested that higher amounts would have been appropriate, totalling $60 million.

[421] It is unlikely that Richina Pacific would have taken steps to fully recapitalise Mainzeal by the provision of funds, particularly at these levels. As I have found, it was very difficult to get funds out of China, particularly funds of this size. Mr Yan

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90 See [293] above.

explained the difficulties that arose in trying to get the $20 million worth of funding in 2008/2009. So, it is unlikely that such steps would have been taken at the time.

[422] The alternative would have been to provide a legally binding commitment of support, as the legal advice in December 2012 suggested. The letters of support had been provided in connection with the annual audit, and Richina Pacific itself had provided such letters in the earlier years. It is possible that the directors' insistence on the arrangements changing could have led to Richina Pacific being prepared to provide such expressions of support in the form that had previously been provided, but in a way that was legally binding. Had that been done, it would have had profound significance. The letters of support would have operated as an effective indemnity of all the losses that might arise on liquidation. Richina Pacific would not have been in a position to withdraw support as it did in early 2013.

[423] Given the impact that resignation of the directors would have had, in my view, Richina Pacific would have been prepared to provide such legally binding support rather than accepting resignation. But it is highly likely that Richina Pacific would have wanted to limit its liability — that is, that a legally binding commitment of support would have been provided, but not in unlimited terms.

[424] There are a number of ways in which this could have been achieved. The most obvious way, however, would have been for Richina Pacific to become legally responsible for repaying the intercompany loans, either by guaranteeing their repayment or restructuring the loans so that they were to Richina Pacific itself. It was the extent of the intercompany loans that caused Mainzeal to be balance sheet insolvent, and these represented the extent to which Richina Pacific had extracted funds from Mainzeal, together with reasonable interest obligations. Thus, a legally binding obligation to repay the loans would have dealt with the balance sheet issue, and would have represented a reasonable obligation for Richina Pacific to meet. Had it been necessary, I would conclude that this is what would most likely have happened had the directors acted in accordance with their duties.

[425] Mr Hodder argued that the likely outcome of the directors insisting on a reorganisation of the arrangements would simply have been a recapitalisation of

Mainzeal by an amount similar to that proposed for the redeemable preference share funding in 2008/2009, and that this would not have made any difference to the ultimate fate of Mainzeal in 2013. I do not agree with this analysis. First, a level of capitalisation of approximately $20 million would not have been sufficient to allow Richina Pacific to avoid remaining liable under the construction bonds. In my view, Richina Pacific's liability under those bonds was one of the main reasons why it invested a further $11.6 million into Mainzeal before its collapse. So such capitalisation would have made a significant difference to the prospect of failure. Secondly, for the reasons I have already indicated, I do not accept that recapitalisation is the likely course of events had the directors declined to continue to trade in the manner Richina Pacific was inducing.

[426] As I indicate above, I do not think it is necessary to demonstrate that the directors would have been successful in preventing the group from continuing the vulnerable trading approach. In my view it is sufficient to show the directors agreed to trade on this basis, that this caused the substantial risk of serious loss to creditors that s 135 contemplates, and that this risk came to fruition. But I nevertheless find for the reasons outlined above that it is likely that the directors would have caused the group to change its approach.

[427] I am conscious of the requirement to be conservative and cautious when there are uncertainties. That includes uncertainties as to causation. In *Shaw v Owens*, the Court of Appeal observed that when exercising the discretion under s 301 "care is required to ensure that the award is truly proportionate to the company's actual loss".[91] The loss to the creditors on liquidation is significant. But this is the very loss that is contemplated by the duties of the directors under s 135 — it is the very risk of serious loss that was involved. The deficiency is directly attributable to the directors' breach. In those circumstances, and given my findings, the starting point for the assessment of the amount to be awarded under s 301 is the entire amount of the deficiency in liquidation — here assessed at $110,646,126.[92]

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91 *Shaw v Owens* [2017] NZCA 315, [2017] NZCCLR 23 at [22].

92 This is Mr Bethell's evidence after deducting the claim of Richina Finance, which has been withdrawn.

Discretionary factors

[428] In assessing the discretionary factors under s 301, the authorities have regarded three factors as relevant — causation, culpability and duration of trading.

[429] In applying those factors, I recognise that there is a difference from the usual reckless trading case where directors continue to trade a company destined to fail. In that kind of case the directors are "… entitled to some sort of credit for the losses which would have been suffered if [they] had not acted in breach …" because there would have been substantial losses to the creditors on liquidation in any event.[93] Here the position is less linear, and no such credit can be readily identified when identifying the starting point. But there are a number of additional factors that would have contributed to the company's failure, and the extent of the deficiency on that failure. These are properly taken into account at the discretionary phase.

Culpability and Duration

[430] Duration is normally relevant to assessing the period of time that the directors continued to trade a company when liquidation was unavoidable. But here it seems to me still to have significance. That is because the directors exposed the creditors to the significant risk of serious loss for a number of years. Their breach of duty was continuous. The directors had many opportunities to correct the manner in which Mainzeal's business was being conducted, but they failed to do so. As a factor, it counts in favour of a significant contribution.

[431] In terms of culpability, I accept that the second to fourth defendants acted in good faith, and with honesty, and that they did so throughout. The breach of their duties arose because they failed to fully appreciate and address the risks they were exposing the creditors to, and because of an unreasonable reliance on assurances expressed in loose terms that had been given to them. It was of no personal advantage to engage in trade in this manner. I regard the small shareholding that Dame Jenny's family trust has in Richina Pacific as largely immaterial for this purpose. In

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93 *Re South Pacific Shipping Ltd (in liq)*, above n 13 at [164](2).

Mr Gomm's case, the directorship can also be seen as largely an extension of his employment as the Chief Executive Officer.

[432] Mr Yan is clearly in a different position. He was in an inherent conflict of interest. He was communicating the expressions of support that the other directors relied upon. The assurances that he gave were misleading. He acted unreasonably in this respect. Mr Yan was also responsible to the other Richina Pacific shareholders, and had a significant personal shareholding. It was not in his personal interests, or the interests of his fellow shareholders, to offer support in a legally binding way. Mr Yan and the Richina Pacific shareholders have benefitted considerably from the funds extracted from Mainzeal. I accept that he also acted honestly, and that he was genuinely committed to Mainzeal. Nevertheless, he led on the other directors in a way that contributed to their breach of duty. For these reasons, I consider his responsibility, and the level of compensation he should be ordered to pay, should be different from the other directors.

[433] Mr Hodder argued, in reliance on the Court of Appeal's decision in *Peace and Glory Society Ltd (in liq) v Samsa*, that the second to fourth defendants should have any liability significantly reduced for discretionary reasons or eliminated altogether.[94] This was because of the lack of any dishonesty, the limited personal advantage and the dilemma they faced. Whilst I accept that many of these factors are relevant, I do not think such factors warrant elimination of liability altogether. These remain significant breaches of directors' duties causing significant losses. It is just for significant contributions to be made, including from the second to fourth defendants.

[434] I also have considered the position concerning the insurance cover held by each of the directors. In opening submissions, the plaintiffs made reference to the insurance cover, and this was objected to by the defendants as inappropriate at the time. When they gave their evidence, some of the defendants indicated that they declined to provide evidence about insurance cover on the basis it was not appropriate to do so. Following my inquiry in closing submissions, however, the defendants accepted that insurance cover was a matter that could be taken into account on quantum, but not on

[94] *Peace and Glory Society Ltd (in liq) v Samsa*, above n 59.

liability. That was following the view expressed by William Young J in *Re South Pacific Shipping Ltd (in liq)*, and applied in other cases, that the ability of a defendant to pay could be a discretionary consideration.[95]

[435] Memoranda following the conclusion of the hearing were also filed explaining how the insurance policy works, given the cover applies to all directors with an overall limit. The policy gives cover of $20 million for all directors in aggregate for any one transaction giving rise to liability, plus the ability for non-executive directors to obtain $1 million extensions. I am unsure whether the liability here would be regarded as only one insured event. Whilst it is not beyond argument, it appears that any limits of cover would result in the benefit being distributed pro-rata. This cover might be relevant to the extent that the directors would otherwise have difficulty in meeting the judgment. One difficulty with my taking this into account, however, is that I did not receive any evidence from the defendants on their inability to meet a significant judgment, although I would be surprised if the second to fourth defendants could do so without insurance cover. Plainly, Mr Yan is in a different category. When no such evidence is provided, the Court has usually not discounted for this reason.[96]

[436] In the end, however, I have decided it is not appropriate to alter what I would otherwise consider to be an appropriate amount to award simply on the basis of the extent of the insurance cover. For the avoidance of doubt, I make no findings on the insurance cover, and how it applies between defendants. I am mindful, however, that the amounts sought by the plaintiffs, and the extent of the deficiency at liquidation, potentially involve very significant sums of money that individuals such as the second to fourth defendants would normally find considerable difficulty in meeting in the absence of support, such as insurance cover.

Causation

[437] The authorities suggest that causation is also relevant at the discretionary phase. On the face of it, to consider causation under s 301 at the discretionary phase is difficult to reconcile with the requirement to identify the loss caused by the directors'

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95 *Re South Pacific Shipping Ltd (in liq)*, above n 13, at [164](1). See also *Mason v Lewis* HC Auckland CIV-2003-404-936, 1 October 2008 (HC) at [104]–[106].

96 See *Mason v Lewis*, above n 11, at [106].

breach as a starting point. How is causation considered again at the discretionary phase?

[438] A consideration of the background to the development of causation as a discretionary factor provides a possible explanation. In *Re Bennett, Keane and White Ltd (in liq) (No 2)*, Eichelbaum J was dealing with a situation where the breach involved a failure to keep business records (as well as other breaches), where it was not clear what loss was caused by the breach.[97] In those circumstances, Eichelbaum J considered causation in a broader sense, noting it could not be regarded as decisive, but that it was an important consideration.[98] Thus, applying causation at the discretionary phase involves a broader consideration of causative factors, including because of uncertainties, rather than the application of the standard legal principles of causation as occurs when identifying the loss to be treated as the starting point. Although this has been described as a factor relating to causation, another way of describing it is to say it involves considering the responsibility for the loss.

[439] When directors continue to trade a company that should cease trading, the losses created by the continuation of trade can be seen as solely attributable to the directors who have breached their duties. But the present kind of case is more complex. Both the causes of the company's failure, and the extent of the losses on that failure, may have been contributed to by factors other than the directors' breach of their duties, even though those breaches are regarded as the cause of the loss as a matter of law. The point is illustrated by the company's trading fortunes. Those trading fortunes will have contributed to the company's failure. In addition, the extent of the liability to creditors on liquidation will also depend on the trading fortunes of the company.

[440] In applying causation as a factor in this sense, I have derived some assistance from two other principles of law that I have considered by way of analogy:

(a) The first is the principle of apportionment arising under the Contributory Negligence Act 1947. Interestingly, the wording of s 3 of

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97 *Re Bennett, Keane and White Ltd (in liq) (No 2)* (1988) 4 NZCLC 64,317.

98 At 64,330.

that Act is similar to that in s 301. The analogy is imperfect because here there are no other tortfeasors contributing to an overall loss. Rather the loss that has arisen is attributable solely to the breach by the defendants. But it assists in assessing what order is fair given the extent of the loss that can be seen to have been contributed to by other factors.

(b) In addition, I have considered damages principles associated with loss of a chance.[99] That provides some help as the breach committed by the directors here involve exposing the creditors to a risk of loss — in effect, the inverse of a loss of a chance. The analogy is, again, imperfect as here the loss has actually come to fruition. But it provides some help in deciding what order might be just, particularly given there are uncertainties as to what would have happened if the directors had met their duties.

[441] Both principles require an overall assessment and are reflected in the identification of liability as a percentage.

[442] In the present case, there are a number of factors that contributed to Mainzeal's failure. The problem with the Siemens contract caused very extensive immediate cash flow issues, and, in addition, there were significant losses arising from the King Façade building supplies from China. The general trading performance was also poor. These factors contributed in their own way to the collapse of this company and the size of the deficiency.

[443] In addition, and notwithstanding that the directors' breached their duties in relying on the assurances of support, there is the feature that Richina Pacific/CHC decided not to continue the support previously promised. Ultimately, this led to the collapse of the company, and contributed to the extent of the deficiency. Having said that, Richina Pacific had provided substantial support during 2012, and also become liable under the construction bonds. This reduced the extent of the deficiency on liquidation that would otherwise have arisen. These features should also be taken into account in deciding what order is just.

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99 See, for example, *Benton v Miller & Poulgrain* [2005] 1 NZLR 66 (CA).

[444] I have described the above analysis as one arising from causation. But arguably, it could equally be described as one arising from culpability. The point is that both the responsibility for the causes of the failure, and the extent of the deficiency, involve other factors. That is so even though the directors have been held to have caused the full extent of the loss arising from the deficiency on the basis of normal causation principles.

Conclusion

[445] In conducting the above analysis, and referring to other principles of law, I repeat the observation made by William Young J in *Re South Pacific Shipping Ltd (in liq)* — I wish to avoid the appearance of spurious precision.[100] In the end, I am seeking to decide what the just contribution should be under a statutory power. Standing back, I ask myself what proportion of the deficiency to creditors on liquidation it is fair for the directors to contribute in an overall way. Given the uncertainties, and the need for caution, I apply a significant discount from the starting point. In light of the relevant considerations addressed above, in my view, an appropriate figure is one-third of the assessment of that deficiency — expressed in rounded figures, $36 million.

[446] There is an alternative way of assessing the position. This can be considered as a cross-check on the reasonableness of this figure. Had Richina Pacific become legally responsible to repay the intercompany advances, it would have faced that liability even if Mainzeal had failed for reasons other than the directors' breach. Given the events of 2012, the amount in question at the end of that year is not certain. At the end of 2011, the intercompany liability was approximately $55.7 million. From that amount, the funds that Richina Pacific invested in Mainzeal during the course of 2012 might be deducted, being the $11.6 million. This can be treated as repayment of these loans in substance, although some of this was already advanced in 2011. In that scenario, the company and its creditors would have been better off by a figure of around $44 million. This provides a further rational and reasonable assessment for a figure that it is just for the directors to contribute. It also would be the relevant figure if Mainzeal was to have failed in any event.

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[100] *Re South Pacific Shipping Ltd (in liq)*, above n 13, at [168].

[447] I also note that this figure I have assessed is similar to the figure of $40 million that it was suggested, by Vero in 2009, was necessary for Mainzeal to be independently capitalised, adjusted with a slight increase to provide greater working capital along the lines suggested by the plaintiffs in closing submissions, less the amount of $11.6 million contributed by Richina Pacific in 2012.

[448] In terms of categories of creditors, the figure is more than the total owed to unpaid employees ($12 million) and general creditors ($9.5 million), but less than that owed to unpaid sub-contractors ($45.4 million) and principal construction contract claimants ($43.8 million).

[449] The figure is also broadly similar to the claims of $32.849 or $44.494 million sought by the plaintiffs in their assessment of loss under the *Mason v Lewis* approach. Referring to what the plaintiffs claim does not demonstrate that the figure referred to above is a reasonable one, but it does demonstrate that the amount awarded broadly corresponds to the amount that the defendants knew was in issue in the proceedings.

[450] For these reasons, I conclude that the amount the plaintiffs should be entitled to recover from the directors under s 301 is $36,000,000.

Joint and several liability?

[451] The final issue is whether the liability of the directors should be joint and several, or whether there should be some form of several liability only. Joint and several liability is usually imposed on directors.[101] But this is not always the case as what is required is the just contribution, and the considerations may be different for different directors.[102] The courts have ordered different amounts in cases against directors when there are different levels of culpability.[103]

[452] I have decided to proceed in a slightly more nuanced way in the present case. This is in order to make determinations that appear to me to be just given regard to the

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101 *Löwer v Traveller*, above n 12, at [87].
102 See *Mason v Lewis*, above n 11, at [116].
103 *FXHT Fund Managers Ltd (in liq) v Oberholster*, above n 84, at [32]–[36]; *Re Global Print Strategies Ltd (in liq)* HC Auckland CIV-2003-404-936, 1 October 2008; and *Re Wait Investments Ltd (in liq)* [1997] 3 NZLR 96 (HC) at 105–106.

factors I have described above, and to reach a result that takes into account the rights that the directors should have against each other, given their relative culpability and the circumstances.

[453] As indicated above, I see the position of Mr Yan being very different from the other three directors. This is because of the following factors:

(a) Mr Yan's breach may have occurred from an earlier stage, and on the basis that he *caused* Mainzeal to conduct trade in a manner leading to a substantial risk of serious loss to creditors.

(b) He was in a conflict of interest position. Given his own personal shareholding in Richina Pacific, and the interests of the shareholders he represented, it was not in his or their best interests to provide a legally binding commitment of support. This compromised the performance of his fiduciary duties.

(c) He misled the directors by the manner in which he provided the assurances of support. He exaggerated what the support was and assured them that there was no need to worry. He failed to live up to his assurances. This was a significant factor in the breaches of duties by the other directors.

(d) Mr Yan and his fellow shareholders in Richina Pacific have benefited very substantially from using Mainzeal's funds to assist in acquiring the substantial assets in China, which are now worth a considerable amount.

(e) The extent of the amount the directors are required to contribute is materially less than the value extracted from Mainzeal to assist in acquiring this wealth.

[454] Mr Chisholm argued that Mr Yan is not a proxy for Richina Pacific in these proceedings. I accept he is not a proxy, but he nevertheless is in a very different

position, as I have just outlined. Indeed, Mr Yan's different position was recognised in the following way in Mr Chisholm's closing submissions:

> 3.2 Mr Yan is accordingly distinct from the other directors in the sense of being a representative of the shareholder(s) and related parties supporting Mainzeal. In this regard he did not have to trust anybody else to know that [Richina Pacific]/the CHC would be continuing to support Mainzeal.

[455] I nevertheless accept Mr Chisholm's further point that Mr Yan's position is also distinct from the other directors because he and his investors have "suffered many millions of dollars of losses by reason of the continuing support of Mainzeal". Mainzeal's failure did duly cause significant loss to Richina Pacific, and the shareholders of Richina Pacific, including to Mr Yan personally. But equally, those parties also benefitted from accessing Mainzeal's cash to acquire assets in China. Moreover, the creditors of Mainzeal have suffered $110.6 million worth of loss as a consequence of the manner in which the business of Mainzeal was conducted, through the arrangements established by the group.

[456] Given these factors, Mr Yan should be liable for the full amount of $36 million. There is no reason to further reduce his liability. But it seems to me that the other three directors should have a limit on the extent of their liability in light of their personal culpability and the other circumstances I have addressed above. In my view, each of the remaining directors should have their liability capped at the amount of $6 million each. I calculate the limit by taking half of the amount I have held the directors should be liable for ($18 million) and dividing it equally between the three remaining directors.

[457] There is no relevant distinction in the position as between the three remaining directors. There may be matters that could be taken into account for each of them but, ultimately, they do not seem to me to change the level of liability that they should be responsible for.

[458] Each of the directors should be liable for that amount, but I believe it is appropriate that they be jointly liable for it with Mr Yan. Each of them is personally liable because of their failure to meet their duties and the consequential loss caused.

Mr Yan is liable jointly with them for this amount because he induced them to breach their duties. To the extent that the second to fourth defendants have difficulties in meeting the liability they should have rights against Mr Yan. That becomes a matter between them.

[459] In order to achieve this outcome, I impose a combination of joint and several liability. Mr Yan should be liable of the full $36 million. Each of the second, third and fourth defendants should be liable for $6 million each jointly with the first defendant. The ultimate outcome is that Mr Yan is severally liable for $18 million, Dame Jenny is jointly liable with Mr Yan for a further $6 million, Mr Tilby is jointly liable with Mr Yan for a further $6 million, and Mr Gomm is jointly liable with Mr Yan for a further $6 million.

[460] I note that the separate amount for which each of the second to fourth defendants is liable is less than the amount awarded against the director in *Re South Pacific Shipping Ltd (in liq)*.[104] The level of liability by comparison with other cases is something I have taken into account in the overall assessment. Obviously, the amount involved in Mr Yan's liability is much more, but this reflects the extent of the loss caused to the creditors together with his personal responsibility and culpability as reflected in the above considerations.

[461] By way of summary, therefore, I make the following orders:

(a) the first and second defendants are jointly liable for $6,000,000;

(b) the first and third defendant are jointly liable for $6,000,000;

(c) the first and fourth defendants are jointly liable for $6,000,000;

(d) the first defendant is liable for an additional $18,000,000; and

(e) for avoidance of doubt:

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104 *Re South Pacific Shipping Ltd (in liq)*, above n 13.

(i) the liability of the first defendant as expressed in paragraphs (a)–(d) above is cumulative and totals $36,000,000; and

(ii) the plaintiffs' full entitlement is $36,000,000.

ASSESSMENT OF QUANTUM BASED ON PLAINTIFFS' APPROACH

[462] In case I am wrong to find that it is inappropriate to assess compensation on the *Mason v Lewis* approach, I will address the evidence and submissions addressed to compensation on that basis. I received very extensive evidence and submissions on this question, and I am conscious that this judgment is likely to be appealed whatever the ultimate outcome, perhaps even through to the Court that Mainzeal built.

[463] In advancing the assessment of quantum on the *Mason v Lewis* basis, two counterfactual dates were put forward — January 2011 and July 2011. Given that I have found that this basis for assessment does not arise at all, I will not make an assessment for July 2011. I see January 2011, the beginning of the new financial year following restructuring, as the more natural date for any comparison. It would unnecessarily complicate this judgment for me to address July 2011 as well. Should it be necessary to assess loss by virtue of a July 2011 counterfactual it may well be that my findings below could be extrapolated.

[464] Expert accounting evidence was given by Mr Apps for the plaintiffs, and Mr Graham for the defendants. Their evidence was focused on the first stage of the test relating to the deterioration of the company's financial position from the breach date compared with the actual insolvency in 2013. In addition to preparing their briefs of evidence, they also engaged in expert evidence conferral and produced an extremely helpful joint statement. Apart from that statement helpfully identifying the issues in dispute, and the respective stance of each expert on those issues, the experts were also able to reach agreement on many important matters. The remaining differences between them involve very significant amounts, however.

[465] In the circumstances, it becomes necessary to address each of the three areas of significant difference between them, and the other relevant evidence relating to those areas of difference.

[466] In their joint expert report, Messrs Apps and Graham prepared a table of the areas of agreement and disagreement, with the estimates of the experts broken down into the issues between them and the financial consequences of each issue. The table begins with Mr Apps's assessment of the loss for January (and July) 2011 at the top, and moves down through each of the issues making deductions from Mr Apps's figures to the extent that I accept Mr Graham's points.

Ref	Description	Jan 11	Jul 11
Mr Apps' primary estimate of loss/(benefit)		**43.928**	**32.186**
Issue 1	Apps adjustment if notional realisation of RGREL adopted (counterfactual)	(5.095)	(3.728)
Mr Apps' alternative estimate of loss/(benefit)		**38.833**	**28.458**
Issue 2	RGREL recoveries (counterfactual)	(6.789)	(10.182)
Issue 3	MLG and RFL creditor advances (factual)	(11.659)	(11.659)
Issue 4	Bay Point project (counterfactual)	(3.375)	(3.375)
Issue 5	Quay Park Arena (counterfactual)	(0.740)	(0.394)
Issue 6	Principal and bond claims (counterfactual)	(26.287)	(5.994)
Mr Graham's alternative estimate of loss/(benefit)		**(10.017)**	**(3.146)**
Issue 7	Graham adjustment assuming the plaintiffs succeed with their eighth cause of action (factual)	(2.010)	(2.010)
Mr Graham's primary estimate of loss/(benefit)		**(12.027)**	**(5.156)**

[467] As the table indicates, if I agree with Mr Apps on all the issues I would be concluding that Mainzeal's creditors would have been better off by $43.928 million as a result of a January 2011 liquidation. By contrast, if I was to agree with Mr Graham on all those issues, I would conclude that Mainzeal's creditors would be been worse off by $12.027 million as a result of a January 2011 liquidation.[105]

105 I note there was an alternative starting point for the plaintiffs' loss in Table 2 of the joint statement, but I conclude that Table 1 is the more appropriate starting point.

[468] Both Mr Graham and (indirectly) Mr Apps added additional issues to be determined as part of the assessment arising after their conferral and joint report. In addition, there were other matters that were accepted or corrected in closing submissions. I will deal with all these additional issues separately below given that the joint expert report and agreed table provides a methodical starting point, and a format, for determining the questions in dispute.

Issues one and two: RGREL recoveries

[469] I can deal with the first two issues together. As at January 2011, RGREL owed Mainzeal $11.966 million.[106] Mr Apps's assessment proceeded on the basis that Mainzeal would have recovered this amount in full in a 2011 liquidation. This was because Richina Pacific effectively supported RGREL, and would satisfy this liability in the liquidation as a consequence. It had positive net assets at December 2010 and December 2011, and Mr Yan had said in evidence in the dispute concerning the attempted liquidation of RGREL that "I confirm to the Court that Richina Pacific will also support RGREL financially (as and when required) so as to allow RGREL to pay its proper debts as they fall due". RGREL was also the entity through which the SBLC financial support was provided in 2012. Moreover, there were underlying agreements associated with Richina Pacific in relation to RGREL's activities, including the original redeemable preference shares subscription agreement dated 28 November 2008, and the Kunshan transaction of 28 October 2009, which would have encouraged Richina Pacific to settle in full.

[470] Mr Graham gave evidence that only a notional liquidation of RGREL was appropriate, and that many of the assets recorded in RGREL's accounts would not have been realisable. He conducted an analysis of what would be realised in the liquidation and concluded that only $80,000 would have been recovered. Mr Apps also did such an analysis as an alternative to his full recovery assessment, which indicated that $6.869 million would have been recovered in a notional liquidation.

106 It is this liability that was later assigned, and dealt with in the above causes of action. At July 2011, the amount involved had increased to $14.504 million.

[471] I see no basis for accepting Mr Apps's view that a full realisation could have been counted on. Mr Apps accepted in cross-examination that he had simply relied on the audited accounts for this analysis, and he had not conducted an analysis of what would actually have been recovered in a liquidation for this purpose. It may well be that Richina Pacific had stood behind RGREL, and used it as a vehicle for transactions, but that does not mean that they would do so in a liquidation of Mainzeal. They have not done so in the actual liquidation of Mainzeal, and Mr Yan resisted RGREL's liquidation.

[472] I accept that there were dealings that Richina Pacific and Mr Yan may not have liked a liquidator of RGREL looking into. They include the redeemable preference shares subscription agreement, the Kunshan transaction, and other general dealings. It is also notable that, following Mainzeal's liquidation, Richina Pacific paid out a substantial sum on a construction bond that appeared to be an RGREL liability, albeit that another New Zealand company, also named Richina Pacific Ltd, was jointly liable.[107] Factors of this kind may have created incentives for Mr Yan and Richina Pacific to avoid a liquidation of RGREL in January 2011. But I do not accept that the liquidators of Mainzeal would have recovered the full amount of the RGREL debt. That is unrealistic.

[473] In terms of a notional liquidation, the reason why Mr Apps identified a much larger amount than Mr Graham arose from three issues. In closing submissions, the plaintiffs focused on only one of those issues. Mr Apps had allowed full recovery of the book value of its investment in Kunshan in the amount of $14.966 million. I agree with the defendants that this is not appropriate. The transaction under which RGREL acquired the shares in Kunshan Richina Hotel Co Ltd was never actually settled — it was conditional upon approval from the Chinese authorities, which was not obtained, or even sought. The evidence was that such approval was most unlikely to have been granted, even if it had been applied for, given that no hotel development on the relevant land had taken place. The transaction was later unwound. For the reasons earlier considered in this judgment, I regard this as an artificial transaction designed to give

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107 It is somewhat surprising that a New Zealand company with an identical name to Richina Pacific ended up being liable on a construction bond. The reasons for that were not explored with Mr Yan or Mr Walker, however, and I take the matter no further.

apparent strength to RGREL's balance sheet only — or as the internal Mainzeal documents referred to it, it created "paper equity" only.

[474] I accept that this issue could have caused embarrassment for Mr Yan and Richina Pacific, and that there were other transactions that could have been investigated in a liquidation that might have caused similar pressure. It is possible, therefore, that a payment would have been made to a liquidator to avoid these lines of enquiry. But the plaintiffs have not proved this is the case to my satisfaction. When Mainzeal was liquidated in 2013, Mr Yan resisted the liquidation of RGREL without making such a payment. That seems to me to be the more likely scenario arising from an earlier liquidation in 2011 — that Mr Yan/Richina Pacific would have resisted a liquidation of RGREL for a period of time.

[475] Mainzeal's liquidators also now have the ability to take whatever steps they like in relation to RGREL's liquidation. I am not prepared to assume a greater financial benefit from an earlier liquidation without it being clearly established. In those circumstances, I accept Mr Graham's analysis that any recovery of RGREL would only have been $80,000. It follows that the amounts in the above table for issues one and two of $5.095 million and $6.789 million are deducted from Mr Apps' starting point of $43.928 million reducing the potential recovery to $32.044 million.

Issue three: Richina Pacific advances

[476] The next issue relates to the funding that was provided by Richina Pacific through the SBLCs during 2011 and 2012. As I have held above, Richina Pacific provided extensive funding during that period, but ultimately it was not sufficient to save Mainzeal.

[477] In the assessment undertaken by the plaintiffs, supported by Mr Apps, the full amount of funding provided by way of advance of $11.659 million is recorded as adding to the deficiency in Mainzeal's liquidation in 2013 — in other words, Mainzeal's creditors are collectively worse off because of the liability to repay the Richina Pacific entities. The defendants argue, supported by Mr Graham, that no such liability should be accepted, as this was equity funding in substance and the Richina Pacific entities have abandoned their claims in the liquidation.

[478] I do not accept the defendants' argument that the advances should be treated as equity funding. This money was provided to Mainzeal by way of advances. It is clear that this form was deliberate, and the legal form mattered. In part, that was due to the need to comply with Chinese restrictions, but I also have little doubt that the debts would have been recognised as repayable had Mainzeal not failed.

[479] But the Richina Pacific entities have not pursued their claim to be repaid in the liquidation. Richina Finance Ltd originally made a claim that was admitted by the liquidators for the debt of $6.017 million, but it subsequently executed an irrevocable deed poll abandoning its claim. MLG never actually made any claim in the liquidation for its debt of $5.642 million and it has also executed an irrevocable deed poll. It follows that the creditors of Mainzeal are not going to face these liabilities. There is accordingly no proper basis on which it can be said that the creditors are disadvantaged by these amounts.

[480] It may be that these irrevocable deed polls were entered for tactical reasons — that is that Mr Yan was seeking to minimise his personal liability arising from these proceedings. That may or may not be so. The issue was not pursued with Mr Yan in cross-examination. But in the end, it does not matter. The creditors of Mainzeal have still nevertheless benefited from this.

[481] The only further argument that was then advanced by Mr Kennedy for the plaintiffs was that equivalent funding would also have been provided in 2011, and without an obligation to repay. I do not accept that. Even if it had been provided in 2011, there would not have been any irrevocable releases given the lack of any strategic reason to execute any. In any event, I find these propositions highly speculative. Moreover, I am not prepared to make those assumptions without this line of analysis having been squarely put to Messrs Yan and Walker in cross-examination.

[482] For those reasons, I accept the defendants' position on this amount, reducing Mr Apps's loss assessment by a further $11.659 million to $20.385 million.

Issues four and five: Specific legacy claims

[483] I also deal with issues four and five together. Both relate to the "legacy" claims in relation to prior works conducted by Mainzeal, and claims made against it in relation to those prior works.

[484] The first relates to a residential apartment block in Oriental Bay, Wellington called Bay Point. There was a leaky building claim in relation to that apartment block. The question is whether liquidators in 2011 would have faced a liability for this matter. Mr Apps made no allowance for any such liability.

[485] This claim was made before the January 2011 counterfactual date. But the board papers in late 2010 recorded that Mainzeal did not think there was much substance to the claim that had been made, with a maximum possible liability of $200,000 identified. There was a major change in attitude in December 2011 after Mr Gomm attended a settlement conference, after which it was decided that, notwithstanding the earlier expert advice received, Mainzeal faced a significant liability. The dispute was settled in July 2012. As part of that settlement, surety bonds in the amount of $3.375 million were provided to cover remediation works that were undertaken by Mainzeal as part of the settlement.

[486] On the approach adopted by the plaintiffs and Mr Apps, no claim is allowed as at January 2011 on the basis that there was no belief at that time by Mainzeal that there was a proper claim against it. Neither was there a bond issued to provide an incentive for the Bay Point body corporate to make a claim in the earlier liquidation rather than pursuing other defendants. The approach adopted by the defendants and Mr Graham is to say that the body corporate would not have been concerned with Mainzeal's perspective and would have pursued the claim in a January 2011 liquidation. Mr Graham took the $3.735 million amount offered as a surety bond as the best approximation of the value the liquidators would have placed on the claim in a January 2011 liquidation.

[487] On balance, I accept the plaintiffs' arguments in respect of this matter. Mainzeal's liquidators were not likely to admit a claim by the Bay Point body corporate in January 2011 given the state of knowledge at that time. I do not think the

body corporate would have pursued the issue with the liquidators, rather than pursuing other defendants, especially when there was no bond. If a bond had been in existence in January 2011 a claim could have been made on the bond, and the bondsman then could have made a claim in the liquidation. But that did not occur.

[488] I recognise Mr Graham's evidence that claiming a liquidation is relatively easy, the liquidator is agnostic, and there is a process for working through the admission of such claims. But the evidence of what happened in Mainzeal's actual liquidation, which I address in greater detail below, shows that not everyone with claims proceeded to have them accepted in the liquidation. Here it is more likely that the Bay Point body corporate would have pursued its claims solely against the other potential defendants who were solvent.

[489] Recognising, admitting, and attending to claims against the company would have been part of the price of trading on from January 2011. Accordingly, I make no deduction for this matter.

[490] The Quay Park Arena liability involves a different issue. It arises from residual issues on the building now called Spark Arena in the Auckland CBD. A surety bond had been issued in relation to Mainzeal's remedial work on that building. In Mainzeal's liquidation, an amount of $2.471 million was admitted as arising from that bond.

[491] Mr Apps assumed the same amount would have been admitted in the January 2011 counterfactual. Mr Graham points to work that was done between January 2011 and January 2013 on this project, and he assumes that $740,000 more would have been admitted in a January 2011 liquidation given the need to complete that work.

[492] I accept Mr Graham's analysis on this issue. The total value of the bond was $3.337 million, but a claim of only $2.471 million was admitted in the 2013 liquidation given the remedial work that had been undertaken. That remedial work had not been undertaken in January 2011. I accordingly accept Mr Graham's analysis that the claim in the January 2011 liquidation would have been higher, and the plaintiffs claim is

reduced by the value of the work, which he assessed at $740,000. I accordingly reduce Mr Apps's loss assessment by a further $740,000 to $19,645,000.

Issue six: Principal contract claims

[493] The next and most significant difference between the plaintiffs and defendants relates to principal contract claims — that is, claims that Mainzeal faced, or would have faced, at the counterfactual dates arising from its liabilities under the construction contracts in existence when the company ceased trading. In 2013, when it went into liquidation, Mainzeal ceased performance of the construction contracts then in existence, and faced claims in the liquidation arising from the contractual obligations to undertake such works. An assessment is required to compare those claims with the claims that would have arisen if Mainzeal had gone into liquidation in 2011.

[494] There are a number of very significant forensic challenges when attempting to make an assessment of what the liability would have been in 2011 compared to the actual liquidation.

[495] First, each one of the construction contracts involved was itself a very significant project. Any assessment of the claims that might have been made by the parties who had contracted with Mainzeal would involve detailed legal and factual questions arising on each of those contracts. Each such potential contractual dispute could give rise to a lengthy trial in its own right. Not only has that trial not taken place, but I did not have any evidence from any witnesses from the parties who contracted with Mainzeal, or indeed any of the Mainzeal employees dealing with those contracts. To some extent this is understandable — the trial of this case took eight weeks in itself. Seeking to address evidence on each of the construction contracts would have been a significant undertaking.

[496] Secondly, as the plaintiffs emphasised, the fact that there would have been a potential loss to a party who had a construction contract with Mainzeal does not mean that a claim would actually have been made in a liquidation. Many parties who may have incurred a loss arising from Mainzeal's failure could have regarded it as pointless to pursue a claim in that liquidation given the extent of the deficiency, particularly if there had been no quantification, or agreed identification of a loss that might have

been claimed. There may have been no point in pursuing litigation against a company in liquidation when liability would be disputed, and quantum was unclear. If no claim would have been pursued, there would have been no loss to Mainzeal's creditors.

[497] Whilst Mr Graham gave evidence that making a claim in the liquidation is relatively easy, and that the liquidators will simply follow a process for recognising that claim, the evidence of what happened in Mainzeal's liquidation here demonstrates that there were many claimants with claims who did not make them in the liquidation. This demonstrates that the existence of a claim that could have been made does not demonstrate that such claims are actually made, or would have been made.

[498] In an attempt to deal with these difficulties, the plaintiffs relied on an analysis set out by Mr Apps in his evidence. Mr Apps looked at the claims that had actually been made in the liquidation in 2013 to provide guidance as to what claims would have been made in an earlier liquidation. His analysis suggested that claims were unlikely to be made in the liquidation unless there was a construction bond in existence. If there was a construction bond in existence, the contractual party would likely make a claim against that bond arising from Mainzeal's failure to continue with the contract for the amount of the bond on issue. A claim was then made in Mainzeal's liquidation, particularly by the bondsman exercising their rights of subrogation, but occasionally by contractual principles themselves for an amount more than the bond cover. This was demonstrated in the following table, which sets out the 26 contracts in existence at liquidation, divided into three categories relating to an assessment made by the defendants' quantity surveyor expert, Mr Andrew Millard:

All $ amounts in thousands

Project	Millard assessment	Factual claims (excluding legacy claims) Bond	Principal	Total	Difference
Millard projects where no claim arose					
Kapiti Aquatic Centre	-	-	-	-	-
Wigram Museum	940	-	-	-	940
Clarendon Tower	946	-	-	-	946
CDHB Fergusson Building	508	-	-	-	508
WIAL Car Park precinct	4,788	-	-	-	4,788
Air New Zealand Koru Lounge and Hub	602	-	-	-	602
QEII Complex demolition	223	-	-	-	223
AIU Hill Morton Hospital	164	-	-	-	164
Rochester and Rutherford Halls	318	-	-	-	318
Massey Food Nutrition Labs	163	-	-	-	163
10 projects	8,652	-	-	-	8,652
Millard projects where claims arose					
MIT Interchange project	8,340	3,262	14,831	18,094	(9,753)
VUW Campus Hub	5,025	1,964	-	1,964	3,061
Manukau Precinct	2,720	500	1,461	1,961	759
ANZ Tory Street	-	676	-	676	(676)
Shed 10	1,913	387	-	387	1,526
Waiheke Library	388	434	-	434	(46)
6 projects	18,386	7,223	16,292	23,515	(5,129)
Projects giving rise to claims not assessed by Millard					
Oral Health Fixed Dental Units package 4 - Browns Road	-	49	-	49	(49)
Lynfield College - New Tuck-shop and Sport Changing Facilities	-	71	-	71	(71)
GEYSER BUILDING	-	2,005	-	2,005	(2,005)
Auckland City Hospital Carpark	-	283	-	283	(283)
ROTORUA HOSPITAL	-	3,008	-	3,008	(3,008)
Vector Arena	-	2,471	-	2,471	(2,471)
Bay Point Residences	-	3,375	-	3,375	(3,375)
Centerport Limited	-	-	274	274	(274)
Stonewood Homes NZ	-	-	737	737	(737)
Robert Stewart Family	-	-	138	138	(138)
10 projects	-	11,261	1,149	12,409	(12,409)
Total	**27,037**	**18,484**	**17,441**	**35,925**	**(8,887)**

[499] The fourth column of this table — "Total" — shows the claims made in the 2013 liquidation. This table demonstrates that of the 26 projects on foot in 2013, claims were made in the liquidation for only 16 (as shown in the second and third parts of the table), of which 13 were covered by a bond. Only three of the 26 contracts resulted in claims when there was no bond. I accept that this demonstrates a correlation between claims made in the liquidation, and the existence of bond cover. It is only very approximate, but it does provide some basis to estimate what may have happened in an earlier liquidation.

[500] Using this as a starting point, Mr Apps made a calculation of what claims would have been made in the January 2011 liquidation, based on the contracts then in place, and the bond cover, as shown in the following table:

All $ amounts in thousands

Project	**Millard assessment**	**Assessed Bond claim**	**Principal**	**Total**	**Difference**
Millard projects where I assess no claim					
RNZAF Ohakea mss bldg	2,799	-	-	-	2,799
Chch town hall	1,901	-	-	-	1,901
Bowen theatres	1,142	-	-	-	1,142
St Andrews prep school	706	-	-	-	706
Kapi mana school	2,565	-	-	-	2,565
Wintec carpark	275	-	-	-	275
ACC fitout Vogel	697	-	-	-	697
Wgtn free ambulance	279	-	-	-	279
Mt Eden normal primary	314	-	-	-	314
Willbank house	286	-	-	-	286
Manurewa netball centre	309	-	-	-	309
Lumley centre recarpeting	175	-	-	-	175
Greenlane CSSD level 2	292	-	-	-	292
Pukekohe police station	207	-	-	-	207
34-42 Willis St	218	-	-	-	218
AJ park fitout	165	-	-	-	165
CDHB boiler house	330	-	-	-	330
17 Projects	**12,660**	-	-	-	**12,660**
Millard projects where I also assess a claim					
Fisher & Paykel building 3	6,801	2,018	-	2,018	4,783
Rotorua hospital	6,681	3,000	-	3,000	3,681
Geyser building	7,515	2,000	-	2,000	5,515
Wgtn sports centre	5,607	1,812	-	1,812	3,795
VUW campus hub	4,455	2,214	-	2,214	2,241
HVDC Haywards **[Note 1]**	10,095	59	7,236	7,295	2,800
Vogel tower	3,906	1,500	-	1,500	2,406
Victory Christian reinstatement	6,634	1,212	-	1,212	5,422
HVDC Benmore **[Note 1]**	12,262	182	-	182	12,080
National library	2,194	1,000	-	1,000	1,194

Project	Millard assessment	Assessed Bond claim	Principal	Total	Difference
Air NZ Chch lounge	1,264	500	-	500	764
ADHB carpark	1,240	565	-	565	675
NDHB Whangarei-Mhipu	2,244	650	-	650	1,594
Air NZ hanger 3	1,812	1,000	-	1,000	812
North wharf buildings	713	316	-	316	397
Massey HS performing arts	468	100	-	100	368
State tower I21-22	261	200	-	200	61
17 Projects	**74,153**	**18,328**	**7,236**	**25,564**	**48,589**
Manukau City Council	-	398	-	398	(398)
Manukau City Council	-	180	-	180	(180)
Greenstone Energy Limited	-	17	-	17	(17)
Manukau City Council	-	75	-	75	(75)
Victoria University of Wellington	-	100	-	100	(100)
Wellington International Airport Ltd	-	253	-	253	(253)
Wakefield Health Limited	-	1,206	-	1,206	(1,206)
DOT NZ Subtrust No. 1	-	127	-	127	(127)
Vector Arena	-	2,471	-	2,471	(2,471)
Te Puke High School	-	-	500	500	(500)
10 Projects	-	**4,827**	**500**	**5,327**	**(5,327)**
Total	**86,813**	**23,155**	**7,736**	**30,891**	**55,922**

Note 1: The principal claim of $7.236 million for Siemens could equally apply to either of the HVDC projects

[501] Thus, on Mr Apps's analysis, Mainzeal would have faced claims of $30.891 million compared with the $35.925 million claimed in the actual liquidation.

[502] The defendants were generally highly critical of this approach. Their primary argument was that the assessment should be made on *actual* liabilities of the company, which should not be influenced by whether a claim would actually be made in the liquidation or not. Their view was that the Court should ignore the question whether a claim would actually have been lodged. I do not accept this point. The object of the exercise is to work out the actual loss to creditors arising from continuing to trade the company after January 2011. In the actual liquidation, not all of those who might have made claims did so. In order to do an appropriate comparison with what would have occurred at the notional liquidation at a counterfactual date, this needs to be taken into account. Otherwise, the actual loss to creditors arising from continuing to trade is not ascertained. There is no point in conducting a purely hypothetical exercise on potential liabilities if it does not result in something that actually affects the position of creditors. The Court is trying to assess actual loss. It is necessary for an assessment of the position in the counterfactual to be conducted on the same basis as in the factual.

[503] I do accept, however, that this approach is only a very rough approximation of what the possible position in a counterfactual liquidation would have been. If there is better evidence of what that would have been, that better evidence should be preferred.

[504] The defendants' quantity surveyor, Mr Millard, engaged in extensive analysis of what the liabilities in a 2011 liquidation would have been. In response, the plaintiffs called their own quantity surveyor, Mr Thomas Jones who did an alternative exercise. Their assessments produced very different figures. Their attempt at a conferral stands in contrast with the accounting experts, as they were unable to agree on anything. It is accordingly necessary to assess the analysis that each of them undertook to see if it provides a better guide than Mr Apps's analysis.

Mr Millard's approach

[505] Mr Millard engaged in a very elaborate exercise directed at identifying what the claims against Mainzeal would have been had it gone into liquidation in January or June 2011.

[506] He began by assessing how much it would have cost Mainzeal's clients to complete the contracts on foot in 2011 by using figures from Mainzeal's accounting system to identify the work done to date. He used the costs-to-date entries from the system to identify the further costs needed to complete. To that assessment, he added a series of uplifts that he said arose from a need to change arrangements for completion. These included an additional number of days to re-establish new contractual arrangements (with resulting costs for matters such as insurance, protection and maintenance, and a claim for liquidated damages as a result) and then a series of percentage uplifts — an additional percentage increase for a construction management fee, a percentage uplift in the margin that a new contractor would change, and additional percentages for a project manager, and to re-establish initial costs called "preliminaries" and "general costs". The uplifts depended on the stage the contract was at, as revealed by the management accounts. For example, on one of the contracts (Fisher & Paykel Healthcare Building 3), the contract had only just commenced, with a total prospective revenue of $74.8 million. Mr Millard assessed that the cost to

complete the contract was $68.3 million, with the additional costs that would arise from change adding a further $6.86 million.

[507] Mr Millard then went through an elaborate approach where:

(a) the uplifted costs he had assessed were added to the costs he assessed were required to complete,

(b) the revenue already received by Mainzeal was added,

(c) an adjustment was made for the margin, and then

(d) a comparison was made between that cost and the total cost that would have been charged had Mainzeal completed the contract itself.

He did that for each of the contracts in place in January and July 2011 (with the exception of some contracts). That included 34 contracts at January 2011, and 22 contracts at July 2011. In his initial brief of evidence, that led him to conclude that Mainzeal would have faced claims of $86.8 million in relation to these contracts as at January 2011, and $63.6 million as at July 2011. These are very significant sums.

[508] Mr Millard then provided evidence by way of reply after the expert accountants had conferred. He accepted in his reply brief that there was a flaw in his analysis, identified by the accountants, arising from his use of the costs-to-date figures from the Mainzeal accounts. These figures did not take into account "principal retentions, debtors and accruals" — in effect, sums recognising that other work had actually already been done by Mainzeal, which affected his calculations. His revised claims against Mainzeal as at January 2011 were $56.8 million, and $31.9 million for July 2011. These are very different, but still very significant sums.[108]

[509] To provide a relevant comparison, Mr Millard also applied his methodology to the construction contracts that were on foot on the date of actual liquidation — January 2013. Adopting this methodology, he assessed in his original brief that the liabilities

108 The reproduced table above at [499] uses Mr Millard's figures before this adjustment.

of Mainzeal at liquidation were $27 million, which was reduced to $20.3 million in his revised brief. These are still significant sums, but they are significantly lower sums than the assessment for January and July 2011. Hence the proposition that the earlier liquidation would have been a lot worse for Mainzeal's creditors by the difference between the figures.

[510] There are, however a number of fundamental difficulties with Mr Millard's approach.

[511] First, as Mr Millard himself accepted, he was only making an assessment of what he thought *could* have been claimed against Mainzeal. He made no assessment of how realistic it was that a potential claimant would have made such a claim in the liquidation. In answer to questions from me, he indicated that he could not offer any guidance on how I could use his figures to work out what might have been claimed in a liquidation. The evidence establishes that his calculations were not a guide at all. Mr Millard's assessment of total claims that could have been made against Mainzeal as at January 2013 was $20.4 million. Mr Apps's evidence demonstrated that Mr Millard's assessments were inconsistent with what actually happened on the liquidation, reflected in the table produced above at [498]. For the first 10 projects, Mr Millard had assessed claims totalling $8.65 million where no such claims were made in the liquidation. For the last 10 projects, Mr Millard assessed there would be no liability, while claims were actually accepted in the liquidation amounting to $12.4 million. The total amount of claims made in the actual liquidation arising from the remaining contracts was $35.9 million — some $15.5 million more than what Mr Millard had assessed.

[512] A further point is that the assessments were made based purely on the information that appeared in Mainzeal's accounting system. Whether the entries in that system are accurate can be questioned. Mr Jones said they were unreliable. I accept there is a real question about that. The fact that one adjustment to this information drastically altered Mr Millard's figures in his reply brief demonstrates that much turns on the assumptions made in the entries in the accounting system.

[513] As a related point, Mr Millard altered his figures by taking into account "principal retentions, debtors and accruals", but when doing so he added back in an entry from the Mainzeal accounting system for Work In Progress — WIP. This gave rise to a somewhat prolonged enquiry during the course of the trial as to what made up this WIP figure. It is relevant that the auditors, Ernst & Young, commented in April 2011 that Mainzeal's accounts could be under or over-stating its position because of management assessment of the amount of work that was in train in the accounts, and that Mainzeal's approach did not comply with accounting standards. In the end, I accept that no proper reliance should be placed on the WIP figure and I am not clear why Mr Millard complicated his calculations by using it. By itself, it renders Mr Millard's approach unreliable.

[514] Each of the assumptions that Mr Millard made to make the upward adjustments for total costs-to-complete can also be criticised, or at least recognised as subject to legitimate debate. To attempt to engage in findings on those matters would largely be meaningless.

[515] There are so many assumptions and uncertainties arising from the analysis that I conclude that Mr Millard's approach is simply not reliable enough to be used as a guide.

Mr Jones's approach

[516] The approach of the plaintiffs' quantity surveying expert, called in reply, had some similarities. One of the main differences was that Mr Jones used the revenue-to-date entries from Mainzeal's accounts to ascertain what work Mainzeal had done rather than costs-to-date. This had the advantage that the figures were not affected by the "principal retentions, debtors and accruals" problem that confounded Mr Millard's approach.

[517] Mr Jones assessed what work remained to be done on each construction project by identifying the revenue that Mainzeal had received on that project. The remaining contract price was the price to be paid under the new arrangements. He deducted Mainzeal's margin from the remaining sum, added back in a new margin that would need to be charged to the new construction partner, and then also added other

miscellaneous items to reach a revised contractual price. He then compared that to the amount that would have been paid to Mainzeal had the contract continued, and then identified that as the potential claim by the party with whom Mainzeal held the contract. His numbers were very different from those assessed by Mr Millard.

[518] When assessing what additional costs would be involved, Mr Jones focused on the standard form contract that was usually in use between the parties (NZS 3910:2003). He emphasised that this contract specifically contemplated the potential insolvency of the contracting party (that is Mainzeal) and provided contractual machinery for that eventuality in clauses 14.2.1–14.2.5. In his view, the party with whom Mainzeal had contracted would exercise what he described as "step in" rights under the contract — namely that this party would itself assume control of the construction project under that contract. It would obtain the assistance of a new construction company to manage the remainder of the construction project, with the existing sub-contractors being continued under the existing contractual arrangements that each had had with Mainzeal.

[519] I accept that there are also significant weaknesses evident in this approach. First, it cannot be assumed that the contractual parties would have acted in the way Mr Jones suggested — that is by exercising "step in" rights. When some of the correspondence that was sent by such parties following Mainzeal's actual liquidation is considered, it can be seen that only one or two exercised such "step in" rights. The correspondence demonstrates that the parties took a range of stances. Most cancelled their contract. Mr Jones's response was that his suggestion was nevertheless the most sensible step that could have been taken by those parties. But, without knowing more about the individual contracts, this cannot be safely assumed.

[520] The second uncertainty affecting Mr Jones's approach is that he used the revenue figure from Mainzeal's accounts to assess how much work had actually been done on the contract to date. He accepted in evidence that he had generally found the data from Mainzeal's accounts unreliable — meaning that it did not necessarily assess how much work had been done on a contract, and how much work there was to be done. But he said that it was the only thing that he had to go on, so he used it. Given that concession, his figures are just as unreliable as Mr Millard's figures.

[521] Furthermore, Mr Jones made no allowance for damages claims being made by the contractual principals, effectively on the basis that it was implicit from clause 14.2.5 of the contract that claims for liquidated damages were not permitted when Mainzeal was failing to comply with its contractual obligations because of insolvency. However, that assumption can be questioned. There was no explicit term excluding liability for damages arising from failure to complete arising from liquidation. Given the presumptions in New Zealand contract law on this question, it is arguable that a claim could be made nevertheless.[109]

[522] Finally, and perhaps most significantly, Mr Jones's methodology would also seem unlikely to provide accurate guidance given the claims made in the 2013 liquidation. Whilst he did not undertake an exercise in relation to the 2013 contracts, Mr Jones's figures were lower than Mr Millard's figures. When Mr Millard had made an assessment for a limited number of contracts in 2013 where claims were in fact made, his figures ended up being lower than the claims that were actually made. This suggested that Mr Jones's approach is equally as flawed as Mr Millard's approach.

Conclusion on quantity surveying evidence

[523] The evidence from the two quantity surveyors was extremely complex. The Court was bombarded with spreadsheets, and revised spreadsheets, with complex analyses on what the claims would have been. But the analyses were all hypothetical, and based on many assumptions unsupported by any actual evidence. I find both of them inherently unreliable. Neither of them helps me with quantifying what the claims would have been for breaching the contracts on foot at January 2011.

What approach should be taken?

[524] In these circumstances, I am driven to carrying out what can be fairly be described as a robust analysis. In doing so, I seek to adopt an approach that appears reasonable, and which is fair to each side. In *Re South Pacific Shipping Ltd (in liq)*, William Young J said:[110]

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109 See, for example, *Dorchester Finance Ltd v Deloitte* [2012] NZCA 226, [2012] NZCCLR 15 at [33].

110 *Re South Pacific Shipping Ltd (in liq)*, above n 13, at [168].

> [168] I wish to avoid the appearance of spurious precision. The figure which I have identified is at best an approximation only of the losses suffered. Given, however, that I am acting on the basis that the primary purpose of s 320 is compensatory or remedial, it does, however, set an appropriate upper limit for the judgment.

[525] I agree with this approach, which was effectively endorsed on appeal.

[526] It is necessary to go back to Mr Apps's analysis, even though this can only provide a rough approximation. Apart from their general criticism, the defendants also criticised Mr Apps's analysis on a number of other fronts. One of the telling criticisms was that Mr Apps's analysis was unlikely to be correct as he had assessed a lower liability for the construction contract claims than in the actual liquidation, notwithstanding that Mainzeal had a larger book of work at the counterfactual date. There is real force in this criticism. I therefore take into account Mr Millard's analysis, at least to the extent it shows that a larger book of work is likely to have led to more claims. In some respects, the plaintiffs realised this themselves, as in closing submissions they adjusted Mr Apps's figures to increase the claims that would have been made in January 2011.

[527] There is one feature of Mr Apps's analysis that is particularly relevant in this respect. Mr Apps singled out the claim made in the actual liquidation in relation to the MIT contract as an "outlier". Here there was a bond liability of $3.25 million, but a claim of $14.8 million was made in the liquidation. In assessing the probabilities of principals making claims without a bond, or making claims in excess of the bond, he excluded the MIT claim. This allowed Mr Apps to advance the theory that the liabilities corresponded to the level of the bonds. I do not think it is reasonable to do this. What Mr Apps's analysis shows is that principals and bondsman could, and did, make claims exceeding the bond cover. The only reasonable way of making a comparison is to allow for claims exceeding the bond cover on an equivalent basis in the counterfactual liquidation.

[528] In the actual liquidation, there were admitted bond claims of $18.484 million, and total construction contract claims of $35.925 million. No claims were made under the Richina Pacific bonds on issue (a further $10.54 million) or the BNZ bonds (a further $1.55 million). Bond claims admitted ($18.448 million) were close to that claimed ($19.414 million), and the amount claimed represented the total bond cover

excluding the Richina Pacific and BNZ bonds. It seems to me that the only reasonable way that this approach can be used as a proxy for the likely claims in the counterfactual liquidation is to use a ratio. The ultimate construction contract liability was approximately 1.85 times the bond cover (excluding Richina Pacific and BNZ). It appears reasonable to make the same assumptions in relation to the lack of claims by Richina Pacific and BNZ in 2011. As at January 2011, the assessed bond cover, excluding Richina Pacific and BNZ, was $32 million.[111] Applying the same approximate ratio indicates that overall construction contract claims of $59.2 million would have been involved in a 2011 liquidation. This is obviously only a very rough approximation of the likely construction contract claims. But it is supported by the point that the larger book of work in 2011 would likely have led to greater liabilities, as emphasised by Mr Millard. It provides a rational and reasonable, albeit imperfect, basis for assessment.

[529] This figure is $28.309 million higher than Mr Apps' assessment of $30.891 million for January 2011. Applying this figure, I deduct that amount from the interim total of $19.645 million above. This reduces the plaintiffs' claim to a figure of negative $8.664 million.

Further adjustments

[530] Potential further adjustments to the assessment undertaken by the accounting experts were raised during the trial.

[531] First, in closing submissions, the plaintiffs accepted the defendants' point that Mr Apps had made inappropriate calculations in relation to two claims by principals (Siemens and Fisher & Paykel). They said that this resulted in a reduction of the loss by $3.341 million at January 2011 (and an increase of $535,000 at July 2011). As I understand it, however, this would only require an adjustment if I had fully adopted Mr Apps's figures. Given I have not done so, I do not understand an adjustment to my calculations to be required. If I am wrong about that, the issue can be corrected under the leave I am reserving, as explained below.

[111] There were no BNZ bonds on issue at that time, and the value of the Richina Pacific bonds on issue was much lower at $3.9 million.

[532] Three further issues emerged late in the trial. When Mr Graham came to give evidence as the last witness, he sought to make an adjustment to a further issue he had analysed. The experts had not conferred upon it. Two additional issues were also raised by the plaintiffs during his cross-examination. I directed that the experts confer again on these three new issues following Mr Graham's cross-examination. The defendants objected to that given the prospect of raising new evidential material late in the trial, but it seemed to me to be the fair way forward. Both sides were seeking to make adjustments. The conferral did not take place, however, because counsel advised Mr Graham not to confer in a way that would involve any new evidential matters. That was unfortunate. I am accordingly required to address the final three matters without the assistance of the further joint conferral.

[533] The defendants also argued in closing submissions that the two issues raised by the plaintiffs should not be considered at all because they were not pleaded. I do not accept that for two related reasons. First, there was the opportunity I gave for the issues to be further considered by expert conferral. If there had been any real issue concerning new evidence, this could have been identified by that process. Second, these issues involved matters that Mr Apps had put forward for the July 2011 counterfactual in a detailed way, and were available for challenge accordingly. In those circumstances, the issue has been adequately raised in evidence during the trial in ways that allowed challenge. I see no procedural impediment to assessing the correct answer on any of these three new issues.

[534] The adjustment Mr Graham sought to make arose because he had not appreciated that Mr Millard had excluded bonds and legacy claims in his analysis. On this basis, the $2.471 million bond issued in relation to the Quay Park Arena project should be included as a claim existing in January 2011. In closing submissions, the plaintiffs accepted that, if I adopted Mr Millard's approach and rejected Mr Apps's approach, an adjustment was required, but said it should not be made if I agreed to Mr Apps's approach. Having agreed to Mr Apps's approach, at least at a conceptual level, I also agree that such an adjustment should not be made. As indicated, I do not accept that Mr Millard's analysis is reliable, and it is necessary to follow Mr Apps's methodology. This adjustment is not relevant to Mr Apps's approach. Accordingly, I make no adjustment for this matter.

[535] Secondly, the plaintiffs sought an adjustment arising from the fact that Mr Apps had allowed for a $3.5 million recovery from Mainzeal's litigation against Holmes relating to the Quay Park Arena project, which was settled in July 2011, but he had not allowed an equivalent recovery for January 2011. It would appear that he did not do so to give the defendants the benefit of the doubt. Having considered the matter, it seems to me that such an allowance for recovery under this claim should be included. A claim against Holmes could have been pursued by a liquidator following a January 2011 liquidation just as much as it was by Mainzeal itself in July 2011. Accordingly, I allow the increase of $3.5 million.

[536] Finally, the plaintiffs referred to third party contributions in relation to Mainzeal's settlement of the Hobson Gardens claim. The relevant assessment arises from the cost of the remedial work on this project of $13.370 million. Mainzeal received contributions from others who had contributed to the liability — $1.875 million from Auckland City Council, $2.6 million from Archimedia and $175,000 from the Carson Group. Again, Mr Apps had allowed for those third-party recoveries at July 2011, but not at January 2011. Those contributions amount to $4.65 million. I agree that those contributions should be allowed at January 2011 as well as at July 2011. There is no reason why they would only have been achieved at July 2011. This decreased Mainzeal's liability, and thereby increases the claims by $4.65 million.

[537] The net effect of these additional changes increases the plaintiffs claim by $8.15 million to negative $514,000.

Conclusion

[538] The ultimate conclusion is that the creditors were better off than they would have been had there been an earlier liquidation. There would accordingly have been no loss arising from the breach on this approach.

[539] Given that the overall loss to creditors on insolvency was approximately $110 million, the above figure represents less than one percent of the loss. It could be seen as being within a margin for error. This outcome is not surprising. Mainzeal made significant trading losses in the next two years of trade from 2011, but Richina Pacific invested $11.6 million into Mainzeal prior to its collapse, and the Richina Pacific

construction bonds were much higher at the liquidation than they were in the counterfactual. Moreover the book of work was much larger at the counterfactual dates. These factors largely cancel one another out.

LEAVE RESERVED

[540] In undertaking the assessments based on the plaintiffs' approach above, and also in making the assessment of the amount to which the plaintiffs are entitled to by way of judgment, I have engaged in a number of calculations based on the evidence received. I am conscious that it is possible that I have engaged in arithmetical mistakes, omissions or other errors of this kind.

[541] For example, an issue may arise from my finding that the second plaintiff should recover from the eighth defendant under the ninth cause of action. I am unclear whether that might affect the potential recovery of the first plaintiff against the first to fourth defendants for breach of s 135. It is possible that it might, as the claim in Mainzeal's insolvency from unpaid employees may arise from unpaid employees of the second plaintiff, with a related claim by the second plaintiff in Mainzeal's liquidation. If so the recovery may affect that claim, and accordingly reduce the losses by Mainzeal's creditors. I am unsure about this. This is an illustration of potential calculation issues.

[542] During the hearing I indicated that, due to the complexity potentially involved with quantum, it might be necessary to release an interim judgment, albeit that that would be undesirable. I have made an effort to avoid such an interim judgment by engaging in the calculations in this judgment. But given the possibility for arithmetical mistakes, omissions or other errors of that kind, it is appropriate that I should reserve leave to all parties to apply, by the filing of memoranda, to correct any such possible mistakes in relation to quantum.

[543] There is a further issue that warrants leave being reserved. As indicated Richina Pacific has become liable for approximately $19 million on the guarantee of construction bonds, and there were $10.54 million worth of bonds outstanding from Richina Pacific itself on the insolvency. No claim has been made by Richina Pacific in relation to these amounts. Unlike Richina Pacific advances dealt with in paragraphs

[476]–[482] above, there have not been irrevocable deed polls abandoning any claims under these bonds. I, therefore, understand it would still be open for Richina Pacific to make claims in the liquidation in relation to these liabilities. Were this to take place there would be an increase to creditor losses. Accordingly, it is appropriate to reserve leave to the liquidators to apply in the event that any claim is made by Richina Pacific.

CONCLUSION

[544] Companies can be viewed as aggregations of capital created to take business risks. That concept is referred to in the long title to the Companies Act. The designers of the Companies Act decided against continuing with the minimum capital requirements that had been set out in the former Act, but decided to address the need for capitalisation in other ways. The concept of balance sheet solvency was included as part of the solvency test set by the Act, and a duty was placed upon directors not to trade in a manner that caused a substantial risk of serious loss to the company's creditors. Such a risk can arise if a company trades whilst balance sheet insolvent. A policy of insolvent trading may be particularly problematic. Such conduct can give rise to a breach of directors' duties under s 135 of the Act.

[545] Richina Pacific required Mainzeal to follow an insolvent trading policy using its authority as a holding company. It extracted amounts from Mainzeal by way of loan through vehicles that did not themselves have the ability to repay. This money was used by the Richina Pacific group for its considerable advantage — it was used to acquire assets in China that are now extremely valuable. By the end of 2009, the amount so borrowed, including interest, was over $42 million. Excluding the value of these loans from Mainzeal's balance sheet meant that Mainzeal was insolvent, and was continuously so from 2005 through to its failure in 2013. The effective balance sheet deficit was very significant throughout that period.

[546] When a company is part of a wider group, a decision by the directors to continue to trade in these circumstances is not necessarily a breach of the duties set out in s 135. If the company can be assured of group support providing equivalent security to a strong balance sheet, it is unlikely a breach will arise — there will not be a substantial risk of serious loss arising from the insolvency. That was not the situation

here, however, particularly after the Richina Pacific group restructuring in 2008/2009. After the restructuring Mainzeal was no longer directly owned by Richina Pacific, the Chinese and New Zealand divisions were separated, and Mainzeal was instructed to operate more independently. From this point, there was no assured group support — the verbal assurances provided were not legally binding, they were not recorded in writing, they were expressed in conditional form, and were also subject to the stringent limitations of Chinese law which restricted funds being repatriated from China.

[547] A company of this size would not normally be able to trade without capital. Mainzeal was only able to do so because it used money owing to sub-contractors as its working capital. The directors continued to trade Mainzeal in this state, in reliance on Mr Yan's assurances that support would be provided when needed. But the assurances were not reliable. There had always been different views amongst Richina Pacific's shareholders in terms of their enthusiasm for the investment in Mainzeal. Their focus was on investment in China. Even the original acquisition of Mainzeal occurred in order to acquire a subsidiary of Mainzeal that could be used for Richina Pacific's Chinese ventures. Mr Yan sought to manage the different interests, and also sought at the same time to assure the Mainzeal directors that they did not need to be concerned about Mainzeal's effective insolvency. But Mainzeal proved not to be a profitable company, and it was also vulnerable to large one-off losses. In 2012, it suffered further one-off losses to the point that Richina Pacific was no longer fully willing or able to support it, leading to its collapse. The consequence was a serious deficiency on liquidation of over $110 million, with significant debts to sub-contractors, construction contract claimants, employees and other general creditors.

[548] In these circumstances, Mr Yan and the other directors are liable for breach of their duties under s 135. They caused or allowed Mainzeal to undertake business in a manner giving rise to a substantial risk of serious loss to the creditors, being the very loss that eventuated. In the exercise of the Court's powers under s 301, I have determined that the amount that the directors should contribute to the deficiency in liquidation is $36 million, approximately one-third of the total loss arising from the deficiency. I have further determined that Mr Yan should have the principal liability for the full amount, and that each of Dame Jenny, Mr Gomm, and Mr Tilby should be liable for a maximum amount of $6 million each, jointly with Mr Yan. Mr Yan must

face the greater liability as he had an inherent conflict of interest, he induced the directors to breach their duties, and he has benefited considerably from the funds that were extracted from Mainzeal, and which caused it to be insolvent.

[549] I have largely dismissed the plaintiffs' other claims, apart from a smaller claim by the second plaintiff against the eighth defendant, which I have upheld in the amount of $2,164,474.09.

[550] For those reasons, I make the following formal orders:

(a) The first to fourth defendants are liable to the first plaintiff on the basis, and in the amounts, specified at [461] above.

(b) The eighth defendant is liable to the second defendant in the amount of $2,164,474.09.

(c) Leave is reserved to all parties to apply by the filing of memoranda as described at [540]–[542] above. Any such application should be made within 15 working days of the release of this judgment, with any memoranda in response filed within 10 working days of the filing and service of the first memoranda.

(d) Subject to considerations such as any offers made without prejudice except as to costs, the plaintiffs are entitled to costs. The plaintiffs are to quantify their claim and serve it on the defendants within 15 working days of release of this judgment, and the defendants are to respond to the plaintiffs within 10 working days. The plaintiffs may file memoranda seeking an award of costs if there is no agreement within 10 working days of receipt of the defendants' memoranda, with the defendants responding within five working days.

(e) I will assess whether any hearing is required in relation to the reserved leave, or costs, on receipt of the memoranda referred to above.

(f) Leave is granted to the plaintiffs to apply in accordance with [543] above.

Cooke J

Solicitors:
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